HOW PROPERTY TAX WOULD BENEFIT AFRICA

Africa Research Institute

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ACKNOWLEDGEMENTS

The manuscript was edited by Nick Branson.

Design and typesetting by Niki Wolfe.

Africa Research Institute would like to acknowledge the generous assistance of Richard Smith, Chairman of the Trustees.

Published by Africa Research Institute, January 2015.

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understanding Africa today

The developmental benefits of governments taxing citizens, even for modest sums, are often disregarded. African governments have long depended on revenue from natural resources or foreign aid to fund budgets. While the potential contribution that better domestic resource mobilisation could make to national finances has received greater attention since the 2008 global financial crisis, international donors often fail to recall the central role that bargaining over taxation has played in building effective, accountable and responsive states across the developed world. Although never popular, taxation is an essential component of consensual and representative government.

In African states, where the reach of national government beyond capital cities is often limited, reinforcing local revenue generation and collection would enhance state-building and ensure that the potential benefits of decentralisation policies are realised. If governments were to invest in establishing mutual dependence with taxpayers, and enhancing the administrative capacity of the state, improvements in policymaking and local service delivery would follow.

Property tax has been posited as the ideal source of income for municipal governments, given the association between taxes raised locally and the delivery of municipal services and infrastructure. Yet this type of revenue has been neglected in favour of consumption taxes, which as a percentage levy on transactions are less conspicuous than the annual payment of a property tax. If local authorities were to simplify the assessment of rates, make taxpayers aware of the benefits of compliance and address political resistance from wealthy property owners, a tax on land and buildings could underpin local political and economic development.

By Nara Monkam and Mick Moore

Taxation and state-building

Taxation plays a critical role in state-building. Most importantly, it helps to forge a social contract between citizens and the state through bargaining processes between those subject to taxation and the government collecting the revenue. The experience of being taxed engages citizens, incentivising them to collaborate to ensure their money is well spent. Civic activism establishes norms of accountability and scrutiny that encourage the establishment or strengthening of representative assemblies. Such institutions, whether formal legislatures or informal civil society associations, provide governments with an opportunity to secure taxpayer compliance in return for a voice in setting tax policy. They also provide a forum for discussion of public expenditure priorities, ensuring that the benefits of tax revenue are shared by citizens and the state.

“**Taxation plays a critical role in state-building**”

To successfully manage a tax regime, governments must develop effective bureaucracies. The process of institutional reform can produce a number of positive outcomes. Administrative reforms foster expectations of meritocracy and professionalism, which can spread across the civil service, enhancing efficiency. The information required for taxation also increases pressure on related agencies – for example, those responsible for land registration – to improve their services. Tax collection extends the presence and reach of the government across its territory, preventing potential competitors, such as insurgents, from establishing relations of mutual dependence with local inhabitants. Finally, revenue collection generates data and information that can facilitate national economic planning.

The relative predictability of domestic taxation is advantageous compared to fluctuating income from aid flows or the export of natural resources. In an effort to maximise predictable flows of income, the state is therefore incentivised to invest in the prosperity of its citizens, rather than focusing on unearned rents from donors and international commodity markets.

Some African governments have recognised the potential benefits of taxation and established semi-autonomous revenue authorities (SARAs) to professionalise tax collection. Almost all have implemented a value-added tax (VAT) regime on goods and services. However, the formal sector, the prime target of these reforms, often accounts for less than half of the total economy. If a majority of the population is only indirectly affected by taxation, citizens will not be politically engaged. In contrast, a tax on land and buildings would stimulate the processes of state-building outlined above, as well as create a relationship between government and those active in the informal economy. Revenues from property taxation would provide finance to local authorities – a neglected and under-resourced tier of government across sub-Saharan Africa – enabling town and city councils to improve local service delivery and invest in infrastructure, improving living conditions and stimulating economic growth.

The pros and cons of property tax

Property tax is an annual levy on immovable property, such as land and buildings, usually paid by the owner to the state. This form of taxation is closely associated with financing municipal government because of the immediate connection between property values and services funded at the local level. These services may include the provision of water, sewerage, refuse collection and policing, and the maintenance of public parks, schools and roads.

Property taxation is widely regarded as highly progressive and equitable because the sum due is determined by wealth rather than being a percentage on transactions. The fact that land and buildings are immobile means that taxpayers cannot relocate to another jurisdiction to avoid the levy – unless they sell their assets. With well-administered property tax, local authorities can count on a predictable, autonomous, and potentially lucrative source of income.

However, in contrast to consumption taxes such as VAT, where payments are made by a small number of businesspeople, an annual property tax is highly visible to ordinary taxpayers. The fact that property owners are acutely aware of the tax has the potential to enhance the accountability of municipal governments, a positive from both economic (budget restraint and transparency) and political (democratic development) points of view. But that does not make it popular, and the unavoidable and uncompromising nature of property tax has led to it being neglected globally. Levies on land and buildings are estimated to account for 0.5% of GDP in sub-Saharan Africa.[1] The unwillingness to tax property has deprived municipal governments of the capital required to improve local services and infrastructure, undermining social and economic development.

In Africa, as elsewhere in the world, technical and staffing constraints are often cited by national governments as justification for limited or non-existent local responsibility for property tax. Many governments continue to argue that allowing sub-national authorities to become significantly dependent on property taxes that they raise locally will lead to unfairness between richer and poorer localities. Generalised indictments of competence in municipal governments and the risks of disparity are the ostensible reasons why, across Africa, central governments continue to keep local authorities dependent on transfers from the national treasury. Yet reluctance could equally stem from fear of empowering opposition politicians and strongholds.

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This hesitancy undervalues the potential benefits of competition between municipalities in terms of enhanced accountability and government responsiveness, and disregards examples of successful property tax reform. Citizens will not feel the potential benefits of decentralisation until responsibility for revenue-raising is devolved in tandem with responsibilities and expenditure powers. Lagos is a case in point. People are drawn to Nigeria’s commercial capital because of its comparably favourable tax administration and commitment to service delivery. A combination of political competition and an ambition to transform Lagos into a modern “megacity” has resulted in successful property tax reforms, in addition to the development of a relatively efficient bureaucracy in Lagos State. Given the importance of Lagos in the national economy, this is ultimately beneficial for Nigeria as well.

> **People are drawn to Nigeria's commercial capital because of its comparably favourable tax administration and commitment to service delivery**

A spaghetti soup of property taxes

A plethora of different property taxation models exist on the African continent, the legacy of colonial era tax regimes and selective reforms since independence. Governments can tax land, buildings or a combination of the two. Kenya has raised levies on land for over a century, whereas Tanzania only taxes buildings because land belongs to the state. In Uganda, land and buildings are taxed together, while in Malawi, Zambia and Botswana structural improvements on the land are taxed separately.

Taxation rates can be calculated based on plot area, capital value or rental value. Economists argue that the latter two, being *ad valorem* or value-based, are preferable in theory; however, both require a mature and well-functioning property market, which in turn demands clear land ownership and transaction records. *Ad valorem* models also require a large number of qualified valuers, capable of assessing the worth of land and/or buildings at fixed intervals. In the absence of regular revaluations, the levy loses credibility, while tax gains are quickly eroded by inflation and increases in property values. Given the bureaucratic obstacles to obtaining land title, formal property markets remain for the most part embryonic, limiting the practical application of the *ad valorem* model.

Many countries have adopted area-based valuation as a temporary solution. In Ethiopia, Mozambique, the Comoros, and several Nigerian states, municipal governments raise a presumptive levy on buildings based on size and location, simplifying the system to a degree where it is both transparent and easy to administer. Similarly, in Burkina Faso the national government administers a presumptive residence tax, the rate of which is determined by housing characteristics and the supply of local public goods. This residence tax was modelled on the urban tax in Morocco and a rent tax formerly levied in Tunisia. Rwanda initially adopted a similar area-based model, recognising its limited administrative capacity in the aftermath of the 1994 genocide, but has since moved to self-assessment by the taxpayer. This further reduces the administrative burden, but carries significant risks of underpayment.

Following the civil war in Sierra Leone, Freetown, Bo, Makeni and Kenema city councils deviated from the *ad valorem* model enshrined in national legislation and also adopted a simplified, area-based model. Properties were valued based on the dimensions of the structure, construction type, location and accessibility. This equitable approach secured legitimacy for a newly re-established tier of government, while enabling the four local authorities to increase their income from property tax by 300-500% between 2007 and 2010.

Regardless of the valuation model, governments must identify all of the land and/or buildings in a given jurisdiction by undertaking a cadastral survey. Authorities need to obtain as high a coverage ratio as possible, but in practice this can prove expensive and time-consuming. Cadastral information is used to prepare a tax roll, containing a description of the property, its location, and the amount due. Finally, governments must issue tax bills, collect taxes, and deal with arrears. In light of the sensitivities of taxing property, a process for appeals should also exist, either directly to the tax authority or via the judicial system.

Tiered government

Anglophone African countries inherited a property tax system where municipal governments were responsible for administering a tax on land and/or buildings. Local authorities have continued to apply this system. However, across Francophone Africa, property taxation has been for the most part neglected, with municipal governments reliant on transfers from the centre. Since independence, national governments have retained responsibility for tax assessment and collection, although instances of revenue sharing are emerging in

Cameroon, Guinea and Chad. This is a positive development as central governments usually prefer to concentrate their limited resources on reforms that can make a greater contribution to the national treasury rather than invest in improving that revenue generation.

In Nigeria, the 36 states are responsible for property tax legislation. Capital value, rental value and area-based property taxation are all used in various locations. In Ghana, Sierra Leone, Liberia and The Gambia, an *ad valorem* property tax system with discrete values for each rateable property is enshrined in legislation, but a lack of data on the real estate market and a dearth of valuers has rendered this difficult to implement. Of these four countries, only Ghana has training facilities for valuation officers. Sierra Leone and Liberia together have fewer than 50 valuers for a combined population of 10 million inhabitants.

The *ad valorem* model is also favoured in eastern and southern Africa. It has worked well in South Africa and Namibia, where real estate markets are considerably more mature and municipal governments have adequate skills and resources. In South Africa, provincial governments provide local authorities with additional administrative support and training to assist with valuation, issuing bills and collection. Property tax contributes about one-quarter of the annual budget for the country's eight metropolitan councils. The combination of property tax and income from user fees on services – electricity, water and sanitation – has enabled South African cities to become relatively autonomous from the central government. However, this is not the case in rural South Africa and Namibia, where property tax is not collected.

Rural-urban divide, and "tax-farming"

Despite urbanisation, an estimated 60% of Africans still live in rural areas. Basic infrastructure and service delivery remain largely absent in many settlements, while a combination of regressive levies and coercive taxation methods adopted by colonial governments and traditional leaders has undermined trust in local authorities. Many citizens instinctively flee their homes to evade tax collectors, preferring to avoid any encounter with the state. In some rural areas, as well as in informal urban settlements, international non-governmental organisations (INGOs) have circumvented local authorities by presenting themselves as the only providers of services, thus undermining the development of constructive citizen–state interaction.

Rather than address this challenge to state authority head-on, the governments of Botswana, Malawi and Tanzania have contracted out tax assessment and collection to the private sector. “Tax farming” is fraught with risks, however, as contractors have no vested interest in building amicable community relations or in state-building. The desire to maximise income is to the fore, and private firms are therefore more likely to employ coercive rather than contractual taxation methods, which can exacerbate tensions between citizens and the state. If data on properties assessed and revenue generated are not available for – and subjected to – scrutiny, corruption is also likely to be prevalent.

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Outsourcing tax collection is not a sustainable or progressive alternative to developing local administrative capacity. It undermines the development of effective bureaucracies and the social contract between the state and citizens. A more feasible solution to lack of state capacity would be to outsource elements of tax assessment and collection selectively to private sector specialists such as surveyors, IT professionals, accountants and auditors. However, investment in bureaucratic capacity remains essential if local authorities are to sustain improvements in the long term.

Investing in reform

Addressing the administrative deficit in municipal governments is the key to creating an efficient, predictable and lucrative property taxation regime. As demonstrated in Sierra Leone, minor reforms can have a dramatic impact, significantly increasing the tax take and providing much-needed capital for improvements to infrastructure and local government service delivery. This is by no means an impossible task. For example, cadastral surveys can be expedited by deploying the tools of urban planners and engineers such as geographic information systems, digital maps, and aerial photographs. Similarly, the coverage ratio can be significantly increased by digitising property ownership records, or harmonising existing local databases with the national land registry and utility company records. These quick wins can be sustained by ongoing information-sharing between different tiers of government to ensure that property sales result in the new owners being billed correctly.

In the early 2000s, the Nigerien capital of Niamey demonstrated the potential of collaboration between existing government agencies by establishing mixed teams of municipal agents, cadastral surveyors, and representatives from the state water and electricity companies to enable the municipal government to reconcile its property register with street address data in real time. Once established, databases can facilitate the maintenance of property records, issuing bills and dealing with appeals, in addition to strengthening the integrity of the system by removing opportunities for administrative discretion and rent-seeking. In the absence of up-to-date street address data or a functional postal service, short-term contractors can provide the manpower and local knowledge to hand deliver tax bills and pursue delayed payments.

> **“As demonstrated in Sierra Leone, minor reforms can have a dramatic impact, significantly increasing the tax take”**

Municipal governments need to consider carefully how best to ensure widespread compliance. Many taxpayers resist paying their bills due to the lack of any visible benefit, especially in areas where infrastructure is poor and service delivery intermittent or non-existent. Non-compliance with property tax demands can be enforced in principle by the confiscation and sale of property, but in practice such penalties are often unenforceable. In the absence of improvements to public services, local authorities will only earn taxpayer compliance by creating a climate of greater legitimacy and trust.

In Francophone Africa, the first step towards ensuring legitimacy would be to decentralise responsibility for revenue generation and expenditure to municipal governments. Taxpayer education and engagement through participatory budgeting has enjoyed some success in the Cameroonian capital of Yaoundé, Madagascar, Senegal and elsewhere. The close involvement of taxpayers in the budget development process – formulation, legislation, implementation and assessment – leads to more accountable and responsive municipal government, with commensurate improvements in local service delivery and the fiscal social contract.

Political will…

Once local authorities are more widely regarded as legitimate and accountable to taxpayers, and can be relied upon to use tax revenues to provide services of value to citizens, it becomes easier for them to establish fair procedures for revenue collection and enforcement and establish a climate of trust. Residents need to have confidence that their neighbours will pay their share of the tax regardless of their political or economic influence, and that municipal governments are resolved to address any challenges to their authority. It is inevitable that those with significant investments in property will resist the tax, but local authorities must be willing to confront strong vested interests by prosecuting non-payment, enforcing judgments and eschewing the exercise of discretion regarding the tax liabilities of wealthy landowners.

> **The degree of local commitment to targeting elites can be a litmus test for commitment to reform in general**

A comparison of the four previously mentioned city councils in Sierra Leone is illustrative. In Bo, 93% of business owners surveyed in 2012 were able to produce a property tax receipt and 87.5% believed that local elites were successfully prosecuted for non-compliance. In Makeni and Kenema, however, only around 40% were able to produce a receipt, and just 30% were confident of successful prosecution. All three cities had demonstrated rapid revenue gains, but in Makeni and Kenema annual increases stagnated as elites proved resistant to the tax, while the municipal authorities in Bo made further progress due to sustained political will. Comparable statistics are not available for the capital Freetown, but the city council there focused its efforts on taxing large businesses and enforcing a poll tax on all residents, rather than expanding the tax base to include properties owned by local elites.[2]

The degree of local commitment to targeting elites can be a litmus test for commitment to reform in general. However, external advisers wishing to support reform need to have a deep understanding of the prevailing political economy if they are to successfully identify the factors determining the degree of political will. Their analysis must include an assessment of the connections between political and economic elites, the characteristics of local political competition, and whether municipal and national governments are controlled by competing parties. Sustainable reform cannot depend on any of these factors alone and must be built on a genuine commitment by local leadership to emphasise reciprocity and transparency as a means to establish a social contract.

…and persuasion

Building on the foundations of legitimacy and accountability, local governments must engage with the public and carefully consider how property tax is presented. While some African governments have attempted to “name and shame” high-profile individuals and businesses for not paying their dues, others have taken the opposite approach. The national revenue authorities in Rwanda, Tanzania, and Uganda hold an annual taxpayers’ appreciation week during which the benefits of paying taxes are communicated to citizens. A similar model could be deployed locally to make citizens aware of the advantages of paying their property tax bills.

This approach could be taken one step further by rebranding property tax as a local “benefit tax”. This would enable African citizens to buy in to the idea of paying taxes in return for infrastructure and services provided by municipal governments. In urban areas, in particular, property tax has the potential to be reframed as a means to generate revenues that are earmarked to finance improvements that directly benefit property owners, such as waste collection, street lighting, roads and public spaces.

This link in the minds of taxpayers between compliance and local service delivery is exactly what the many hundreds of African municipalities now practising participatory budgeting are seeking to promote. Its successful promotion is certainly one of the factors underlying the success of property tax in post-conflict Sierra Leone. Following reforms to the assessment method there, local authorities conducted extensive public education and awareness campaigns. Radio presentations and call-in shows provided a platform for councillors, tax officials, paramount chiefs and religious leaders to explain to taxpayers the basis of the levy, how revenue would be spent, payment methods, and appeals procedures.

As African cities expand and the urban middle class grows, greater awareness of – and respect for – property rights and obligations could provide the legal and financial foundations for individuals to access credit, using their land and buildings as collateral. This would in turn help to improve land tenure systems and property markets in urban areas, in addition to providing an added incentive for tax compliance. Municipal governments could conceivably shift then from area-based to value-based property tax, although this remains a distant prospect for many.

Recipe for reform

The potential of property tax for both municipal governance and state-building is clear. A combination of legislative reform, technical know-how and political will is required to ensure that the levy becomes a durable source of income for local authorities. In many countries, especially in Francophone Africa, decentralisation policies have been enshrined in legislation, but their provisions have not been enacted. The reform of local government finance should be a priority for policymakers, but they will need determination to build alliances and confront vested interests if they are to mobilise and sustain lucrative revenues from property taxation.

A number of positive trends give rise to cautious optimism regarding property tax in Africa. Prosperity is increasing and an educated, politically-engaged middle class is emerging in many countries. Social scientists identify this as a sign that the tax take should increase.

Africa is also increasingly urban, amplifying popular pressure on municipal governments to *do something*. This in turn necessitates a reform of municipal government financing and creates opportunities for the introduction of comprehensive and effective property taxation. The spread of participatory budgeting, for example, is evidence that citizens are increasingly demanding rights, services and accountability in local government. Finally, declining oil and commodity prices and aid flows are already beginning to expose the dependence of many African governments on external rents, providing an incentive to focus on domestic revenue generation potential.

“The future of African national and municipal governments will depend on institutions and tax policy that are equitable, improve local service delivery and encourage compliance through establishing a social contract between taxpayers and the state”

Despite the seemingly improving outlook for the introduction of property taxes, progress remains sporadic. Across much of Africa, decentralisation has stagnated. Renewed impetus is urgently required if municipal government finance is to be reformed and the potential of property taxation realised. International donors need to be more mindful of the role of domestic resource mobilisation in underpinning effective, accountable and responsive states. Similarly, INGOs must consider the long-term implications of circumventing domestic institutions and undermining, deliberately or otherwise, the authority of governments attempting to forge a relationship of mutual dependence with taxpayers. The future of African national and municipal governments will depend on institutions and tax policy that are equitable, improve local service delivery and encourage compliance through establishing a social contract between taxpayers and the state. Property tax is one of the more effective means of realising these goals.

Notes

[1] See Fjeldstad, Odd-Helge and Heggstad, Kari, “Local Government Revenue Mobilisation in Anglophone Africa”, ICTD Working Paper 7, Institute of Development Studies, p.15

[2] Jibao, Samuel and Prichard, Wilson, “Rebuilding Local Government Finance After Conflict: The Political Economy of Property Tax Reform in Post-Conflict Sierra Leone”, ICTD Working Paper 12, Institute of Development Studies, p.22

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