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Roy W. Bahl
Georgia State University, rbahl@gsu.edu

Musharraf Cyan
Georgia State University, cyan@gsu.edu

Sally Wallace
Georgia State University, swallace@gsu.edu

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and **Musharraf Rasool Cyan**

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Underutilized Land and Property Taxes

Roy Bahl, Musharraf R. Cyan, and Sally Wallace

Land and property taxes with a few exceptions are assigned to the provinces. A central issue of provincial finance in Pakistan is the significant vertical imbalance in the intergovernmental fiscal system. The four provincial governments account for 35 per cent of all government expenditures, but only 7 per cent of all taxes.[1] At a time when central government taxes are only about 10 per cent of GDP, there is a premium on increased revenue mobilization by provincial governments. The federal government has called on the provinces to double their tax-to-GDP ratio in the medium term.[2] This heightens the importance of land and property taxes from the revenue perspective.

The barriers to such an increase in revenue mobilization by provincial governments are formidable. They range from structural problems with the present tax system, to administrative shortcomings, to the absence of incentives for provincial governments to increase their tax effort. There, also, would appear to be some murkiness in revenue assignments between levels of government, and some important constitutional limitations on the choices that provincial governments might make. This chapter presents a detailed discussion of urban immovable property tax, taxes on land and property transfers, and agriculture income tax in Punjab and Khyber Pakhtunkhwa (KPK) provinces. The former province has a large tax base, while the latter has a small tax base. The land and property taxes in Sindh and Balochistan are organized on similar lines.

1. REVENUE ASSIGNMENT AND STRUCTURE

The Constitution of Pakistan lays down a separation of taxing powers. In general, the provinces are denied access to the broad-based and more revenue productive income and consumption taxes. These tax assignments have left the provinces with bases that are hard to reach, the income tax on agriculture and the sales tax on services, or costly to administer, the property tax. Some would argue that the constitution also closes off possibilities for tax base sharing by the federal and provincial levels of government, but not everyone agrees with this interpretation. India's intergovernmental system is also built around the constitutional principle of separation of tax bases vs. concurrent taxing powers, as are allowed in many federal countries.[3]

Provincial and local government taxes are authorized by provincial acts and the provincial governments have some authority to alter tax rates and bases and to administer their own taxes. The tax structure and administration in Punjab and KPK are similar in many respects suggesting either a heavy central influence or some 'copycat' behaviour.[4]

The structure of taxes is summarized for Punjab and KPK provincial governments in Table 1. Data on local government taxes are not available. It should be kept in mind that in both provinces, total own source revenues are so small that they play only a minor role in financing. While there are more than 15 tax sources available to the provincial governments, most revenues in Punjab are derived from taxes on property transfers, including stamp duties, mutation and registration fees, and from taxes on motor vehicles.

Table 1
Revenue Structure of Provincial Governments (2005–2006)

	Punjab		Khyber Pakhtunkhwa	
	Rupees (in millions)	% of own source revenues[a]	Rupees (in millions)	% of own source revenues[a]
Direct Taxes				
Urban property tax	674	2.28	300	6.70
Agriculture income tax	658	2.23	70	1.56
Registration fee (transfer of property)	2,113	7.15	42	0.94
Land revenue[b] (includes mutation fee	3,392	11.48	330	7.37
Taxes on professions, trades & callings	225	0.76	75	1.67
Indirect Taxes				
Motor vehicle tax	4,154	14.06	677	15.11
GST on services	2,224	7.53	420	9.37
Stamp duties	5,859	19.83	300	6.70
Entertainment tax	13.0	0.04	13	0.29
Electricity duties	1,270	4.30	270	6.03
Hotel tax	245	0.83	29	0.65
Provincial excises	846	2.86	30	0.67
Education cess	0.00	0.00	57	1.26

(Cont. on next page)

Table 1

Revenue Structure of Provincial Governments (2005–2006)

	Punjab		Khyber Pakhtunkhwa	
	Rupees (in millions)	% of own source revenues[a]	Rupees (in millions)	% of own source revenues[a]
Cotton cess	443	1.50	–	0.00
Other[c]	31.0	0.11	43	0.96
Total[d]	22,180	74.97	2,762	59.27

Source: Calculations are based on provincial revenue time series data provided by the World Bank, Islamabad.

Notes:

a. Own source revenue is a total of tax and non tax receipts.

b. Includes transfers by mutation and miscellaneous land revenue.

c. The 'other' category is calculated as a residual and there are wide variations between years, indicating there may be changes in classification. The KPK collection reported under 'other' is Rs. 150 for 2005–06, while it was less than Rs. 5 million in the three preceding years. We use the average amount of the four years for this table.

d. The total does not add to 100% because non-tax receipts are not included. The total for KPK is based on actual collections in 2005–06 and does not use the calculation for others described in note 'c'.

In the case of Khyber Pakhtunkhwa, motor vehicle taxes, property transfer taxes and the GST on services are the most important own source revenues. The concentration of tax revenues may be illustrated by the following. In Punjab, 8 of the 14 tax sources listed in Table 1 account for only 14 per cent of the tax revenues. In Khyber Pakhtunkhwa, 8 of the tax sources listed account for only 10 per cent of the collections. Administrative effort seems to be spread quite widely. This suggests that a less complicated tax structure might allow more administrative effort to be directed toward those taxes that have a greater revenue potential. This recommendation has also been made in earlier reports.[5]

While the tax structures described in Table 1 outline the current practice, they do not show the structure that would arise, if full revenue potential was reached. The provinces do have access to some taxes that have broad enough bases and potentially enough built-in growth to form a more revenue productive tax system. This list would certainly include the property tax, motor vehicle taxes, and the sales tax on services. However, all of these taxes presently are levied at very low effective tax rates, so that they yield a relatively low level of revenues. In the analysis presented in the report, we look for the determinants of this underperformance.

It is no easy matter to compare tax structures among provincial-level governments in developing countries. Different countries give different names to subnational government taxes and there is no ready source of international comparison. The following examples give some feel for the variation, and for the possibilities.

Both Argentina and India allow states to levy broad based sales taxes, though local rate-setting discretion is not allowed in the India case.

- Russia experimented with a subnational sales tax from 2001–04, which raised substantial revenue. Subnational governments were allowed some rate setting authority.
- The principal revenue source of Colombia's departments and provinces are excises, principally on alcoholic beverages, tobacco, and gasoline.[6]
- Punjab and KPK, as well as Balochistan and Sindh, follow almost exactly the same pattern of tax administration, owing to the fact that a uniform system was in place for all provinces between 1954 and 1970. The Excise Tax Department is responsible for collection of most taxes, including the taxes on urban property, motor vehicles, excises, and entertainment. The Board of Revenue collects the taxes on rural properties, agricultural income, property

transfers, and other stamp duties. There appears to be little coordination between the two arms of the provincial tax administration and this compromises collection efficiency.

The sales tax on services is assessed and collected by the central government on behalf of the provinces, but there is little cooperation between the two levels of government in terms of information sharing.

2. URBAN IMMOVABLE PROPERTY TAX: PUNJAB

The property tax in Punjab is levied by authority of The Property Tax Act of 1958. Following the Local Government Ordinance of 2001, it is designated a local government tax and the city districts and TMAs have the authority to set the rate. Assessment and collection can be at the district level. In terms of the actual practice however, the UIPT is a provincial level tax subject to revenue sharing with the city districts and TMAs.

Recently, the provincial government approved a medium term policy framework to decentralize the property tax administration to local governments and carry out other reforms.[8] According to the framework, by 2012 the provincial government will assign tax policy and collection to five city district governments and Tehsil Municipal Administrations in other districts, while it will retain a role for itself for oversight and policy advice. The assignment of powers and functions to TMAs will follow a 'readiness' criterion. Details of the new legislation, staff assignment from provincial government to local government and guidelines on valuation will be worked out as this framework in implemented. The provincial government will continue to provide the legislative framework for levying property tax, i.e. questions relating to defining the tax base and the basic methodology for calculating tax liability will stay with the province for now.

The UIPT is an old tax in Pakistan, but it has never generated significant amounts of revenue. For instance, the national property base was estimated to be Rs. 70 billion in 1996 and if the statutory tax rate were only 10 per cent, the national collection would have been Rs. 7 billion in that year.[9] Property tax collection in all four provinces in 1995–96 was only Rs. 506 million. In 2002–2003, it had increased to Rs. 2.795 billion, still much below Rs. 7 billion. With the new medium term policy framework, and the overall decentralization initiative in Pakistan, there is an imperative to upgrade the property tax to a significant revenue source.[10] As is discussed below, there is ample revenue potential, but implementing structural and administrative reform will be no easy task. In particular, there is a question about when the TMAs and city districts will be able to effectively administer the UIPT.

Revenue Performance

The urban property tax in Punjab produces a very modest amount of revenue, even by developing country standards. In per capita terms, the yield was less than Rs. 13 (USD$ 0.31) in 2006. Collection fell in 2005–06, to a level equivalent to about 4 per cent of own source revenues and 0.03 per cent of GDP, Table 2.[11] This level of collections is low in the absolute, and it is low by comparison with other developing economies, where the average is about 0.5 per cent of GDP.[12] We note, however, that there is great variation among developing and transition countries in the level of property taxation that they choose, see Table 3 and Box 1.

Table 2
Revenue Performance of the Urban Immovable Property Tax

Years	Per capita Nominal Amount (Rupees)[a]		Per capita Real Amount (Rupees)[a,b,c]		% of own source revenue[a]		% of GDP[d,e]	
	KPK	Punjab	KPK	Punjab	KPK	Punjab	KPK	Punjab
1999–2000	3.63	2.39	3.628	2.39	2.55	1.14	0.019	0.009
2000–01	7.19	5.86	6.641	5.42	5.23	2.74	0.036	0.020
2001–02[f]	8.26	0.33	7.464	0.30	5.19	0.17	0.039	0.001
2002–03	7.72	11.67	6.677	10.10	4.96	5.22	0.034	0.036
2003–04	10.78	10.73	8.654	8.62	5.80	3.93	0.042	0.029
2004–05	10.20	18.44	7.651	13.83	5.09	5.70	0.034	0.044
2005–06	14.17	12.45	9.733	8.55	6.54	3.84	0.041	0.026

Sources:

Calculations are based on:

a. Provincial revenue time series data provided by the World Bank, Islamabad
b. NIPS population data
c. FBS GDP deflator
d. Punjab Bureau of Statistics, provincial GDP estimates
e. KPK GDP estimates from Government of NWFP (2007a)
f. In 2001–02 the one year dip in collections in UIPT collection occurred due to the legal challenges to the new valuation roll.

Note: Base Year = 1999–2000

The revenue elasticity of the property tax can be calculated as the ratio of the per cent increase in property tax revenues to the per cent increase in GDP.[13] Ideally, the elasticity of the property tax would track the GDP elasticity of local government expenditures, which would appear to be close to unity in Punjab. The year-to-year pattern of collections in Punjab has been too erratic to allow meaningful point estimates of the revenue-income elasticity.[14] The arc elasticity during the period 2003–06, when the 2002 roll was in effect, is 0.24, i.e. revenues from the property tax grew at about one-fourth the rate of provincial GDP. The major source of revenue growth, the introduction of the new valuation roll, has been postponed. Thus it is almost certain that property tax revenues did not keep pace with the demand for provincial and local government public services during this period.

Table 3
International Comparison of Property Tax Revenues: Selected Countries

Country[a]	% of GDP
Pakistan[b]	
Punjab	0.026
KPK	0.041
Chile	0.7
Ethiopia	0.5
Croatia	0.2
Indonesia	0.1
Slovak Republic	0.6
Sri Lanka	0.7
Thailand	0.3
Hungary	0.3
Poland	1.1
Argentina	0.9
Mexico	0.3
South Africa	0.7

Sources:

a. Bahl and Martinez-Vazquez (forthcoming) and calculations from IMF (2005) for all the countries reported in the table except Pakistan.

b. The Pakistan provincial percentages are authors' calculations reported in Table 12.

Box 1
International Practices in Property Taxation

A remarkable feature of the practice of property taxation in developing and transition countries is its wide variation. Countries have chosen to tax rental value, Columbia, site value, Jamaica and capital value, Philippines, and in some cases the local governments are free to decide on their own base, South Africa. Exemption policies vary widely, e.g. Thailand exempts owner-occupiers and Tanzania taxes only buildings. Some countries have progressive rate systems while others choose flat rates. Central governments levy the property tax in some countries, Indonesia, state governments in some cases, India and local governments in other countries, Hungary. Fiscal planners in Pakistan will not have much luck in looking for a generally accepted 'best practice'.

With respect to problems, however, there are some commonalities. Most developing and transition countries are plagued by weak administration, which leads to undervaluation, incomplete cadastres, and low collection rates. A commonly cited underlying problem is an acute shortage of skilled staff.

For discussion of the international practice, and of individual country practices.[15]

Rent and Base

In, Punjab, the property tax is levied on a base of annual rental value at a flat rate of 20 per cent on properties with an annual value of Rs. 20,000 or less.[16] If annual rental value is greater than Rs. 20,000, a flat rate of 25 per cent is applied. Section V of the act defines Annual Rental Value (ARV) as the amount of rent that could be obtained in an unencumbered market transaction, less an allowance for maintenance and repairs. A large number of 'special treatments' of properties, however, have moved the assessed base to one that barely resembles this definition of ARV.

Exemptions and preferential reductions in tax liability include:

- A 10 per cent reduction in taxable value is allowed for every property, to provide for maintenance expenditures, 'depreciation'. This would seem to be in keeping with the defined tax base.

- Owner-occupied units are assessed in a way that the imputed ARV is about one-tenth of the ARV of a comparable rented unit. So, owner occupiers pay 10 per cent of the normal tax liability. One might speculate that since two-thirds of housing units are owner occupied, this preferential treatment was driven by political considerations.
- Owner-occupied, residential properties with a lot area less than 5 marla, 125 square yards, are exempt. Vacant properties are not taxed. The results of this preferential treatment are that an estimated 300,000 of 750,000 properties in Lahore are not taxed.
- Retired government employees who are owner occupiers enjoy an exemption if they live on plots up to 500 square yards of land.
- Widows, orphans, and the disabled receive a deduction of Rs. 48,000 in ARV.
- Government properties are not taxed. Properties in cantonment areas are not taxed.
- Other exemptions, charities, religious use, etc. seem to follow normal practice.

Valuation

Valuation is the responsibility of the provincial Excise Tax Department (ETD) and the devolved district excise tax departments. Under the new framework, valuation will be given to local governments over time. Leadership in this work, methodology and overall guidance, remains with the Provincial E&T department. A valuation table is developed using a combination of market data and expert judgment about rental values. This table serves as the basis for valuing all properties in the province.[17] The methods employed to arrive at taxable value are somewhat similar to those used in other low income countries that follow the area method.

The department issues a valuation table that shows value per area unit[18] in various 'value zones', with differentials on 'main roads' and 'off main roads'. The valuation rate per area unit falls after a threshold level of land area, or structure area, is reached. There also is a use factor in that different valuation tables apply to residential and commercial properties, with the latter carrying higher rates. When one takes account of all the different categories of property use and value-determining characteristics, there are 392 different valuation classes.[19]

Determination of Tax Liability

The determination of tax liability for a property might be best understood by tracking through the steps taken by the excise tax department.

A location zone (A–G) must be selected from the valuation table, and on-road/off-road character of the property must be designated. The 'A' areas are the prime locations, usually closer to the city centre.

- The property must be classified as residential or commercial, and if residential, as owner occupied or rented. Industrial properties are classified as residential for purposes of property tax.
- The property tax base (ARV) is calculated as the number of square yards of land multiplied by the valuation coefficient for land, plus the number of square feet of covered area multiplied by the valuation coefficient for structures. A

10 per cent reduction for maintenance is applied to all properties.

- Residential, owner-occupied properties with a lot size of less than 5 marla are exempt. Vacant land is exempt.
- Rent control creates a distortion in the rental value market and would depress the ARV.[20] Other exemptions, as noted above, are taken account of.
- A tax rate of 20 per cent is applied if ARV is less than or equal to Rs. 25,000. If the ARV is greater than Rs. 25,000, a tax rate of 25 per cent is applied to the full value of the base. Preferential rate reductions are taken into account at this point in the process.

Appeals and Collections

After a draft valuation list is prepared, it is opened for review and objection. The final list is reported in the PT-1 file. The other controlling document is the PT-8, which shows the tax payment history for 5 years, and all outstanding arrears.[21]

The Excise Tax Department (ETD) demands payment by sending a notice, and then a follow up notice. If payment is not made, ETD has the power to attach a property. In fact, this is rarely done. The owner is liable for payment, but collection may be taken from the tenant. Payment may be made directly at designated banks, branches of the State Bank and the public owned National Bank, and a 5 per cent discount is allowed if payment is made early. Total delinquent taxes are equivalent to about 10–15 per cent of annual liability. This is not an unusual level for developing or transition countries.[22]

Issues and Problems

The UIPT in Punjab is beset by a number of problems. For implementation of the medium term policy framework, a number of issues will require attention. Some are structural and some are administrative, but none are insurmountable with present levels of technology and with some upgrading of staffing numbers and skills.

The tax base. The legal basis for property taxation is annual rental value. Many observers take the position that this tax base is not appropriate for Pakistan. One reason is that most residential properties in urban Pakistan are owner-occupied vs. rented, so the capital value of a premise would be a more compatible base. Advocates argue that it would be more acceptable to taxpayers. Another issue is that vacant properties are not taxable under the present system because they 'have no rental value'. A capital value base presumably would allow taxation of vacant properties. Finally, the valuation of industrial properties is uncertain under a rental value system, because a capitalization rate must be assumed. Under a capital value system, a reconstruction cost method of assessment, or even a book value approach, could be used. These latter two problems are longstanding criticisms of the annual value system that might be remedied by adopting a capital value base for property taxation.

There are, however, problems with the capital value base. Most of these have to do with valuation. One assessment approach is to estimate the market value of the total property, land, and structure. This is a very expensive process that requires a cadre of skilled valuators. It does not lend itself well to mass appraisal in most developing countries.[23] The basic problem is that valuation under a capital value system requires accurate data on sales of properties. With the high property transfer tax rates that now exist, accurate reporting of sales values is not likely.

The alternate approach to valuation is to separately estimate the market value of land and structures, probably using some notional approach to valuation. If this took the form of land value coefficients and a construction cost table for structures, as is done in many developing countries, the system would not be very different from that presently in force in Pakistan. Other than resolution of the vacant land issue, there might be little to gain from switching to a capital value base.

A third approach is to tax the land only. The advantage here is that assessment is not very different from what is done now; establishing location values within urban areas and landowners are given no disincentives to develop the land in its optimal use. Assessment would be easier since buildings would not be valued, and the tax roll would be easier to keep current since land-related characteristics change less often than buildings. The disadvantage is that nominal rates must be higher to yield the same revenue, and there is a perception of unfairness in that higher valued structures go untaxed.

The argument for capital value is that it offers a way to include vacant properties in the base, and it offers a reasonable way to view the taxable value of industrial properties. It also may be more acceptable, in concept, to taxpayers. Adopting a capital value base would do little harm, and it would be in step with international practice. However, with respect to gaining a better estimate of the market value of residential properties, the switch to a capital value approach may not make much difference. In fact, there is equivalence between the capital value and the rental value systems. Capitalized rental values and capital value are approximately equivalent, if the data underlying the valuation process are accurate. If a capital value base were adopted, and a notional assessment instituted, not much will have changed for residential properties and most commercial properties.

The government of Punjab needs to make a decision either to stay with the rental value approach or to adopt a capital value approach, if it is constitutional to do so. Either way, it will be necessary to develop a method for taxing vacant properties and properly assessing industrial properties, and finding a way to value residential and commercial property at more nearly their market rates.

Tax rate. There is some discussion that a statutory tax rate of 20–25 per cent of annual value is too high, and presumably is above the international average. There was discussion at one point to roll the tax rate back to 4 per cent upon introduction of the new valuation list. The fact is however, that the statutory rate in Punjab, or in most countries, has little meaning because it is levied against a base that is well less than market rental value. If the base were to be fully assessed, the proper level of the normal tax rate would depend on the revenue target chosen, see below. In the absence of an accurate sales-assessment ratio study, we cannot estimate the size of the base that would result from a full market valuation.

Neither is there much merit to the argument that the property tax rate in Punjab is 'too high'. If anything, the statutory tax rate of 20–25 per cent in Punjab is low. The ratio of UIPT collections to GDP is 0.026 in Punjab and the ratio of property tax collections to GDP averages about 0.5 in developing countries.

Low revenues. The revenue yield is very low, about 0.026 per cent of provincial GDP in 2006 and about 2 per cent of provincial government expenditures. We can conclude safely that there is little connect in the eyes of taxpayers between the level of local public services provided and the amount of property taxes paid. Thus Punjab misses the opportunity to charge property owners/ users for the public service benefits they receive, and by so doing it takes a step back from a central tenant of successful fiscal decentralization.

The low revenue yield might be attributed to a number of factors: (a) taxpayers do not see adequate value in the services they receive from local governments, hence they are not willing to tax themselves at a higher rate; (b) the property tax is an inherently unpopular way to raise revenues and elected politicians loathe to force it on to voters; (c) the many who receive property tax preferences resist giving these up; (d) intergovernmental transfers provide subnational governments with adequate revenues at low political cost with the result that there is no incentive for increased property tax effort; and (e) there is weak enforcement. The fact that Punjab officials postponed introduction of the new valuation roll in 2007, because elections were near, is some evidence of the political sensitivity of property tax policy. To move property tax revenues to a higher level, all of these barriers will need to be addressed.

Undervaluation. The evidence available suggests that properties that are in the tax base are dramatically under-assessed. Unfortunately, there are no independent estimates of property values or rental values, so it is not possible to get a fix on the true tax base. Moreover, the government does not carry out an assessment-sales ratio study that would allow calculation of the degree of underassessment, so it is not possible to make an objective estimate of the revenue cost of underassessment. Educated guesses, anecdotal evidence, and some available data, however, suggest that the degree of underassessment is quite large. One senior official in ETD gave an example of a 'good' area of the city where one marla of land, 25 square yards, would sell for Rs. 12 million. Based on the valuation table presently in use, the property tax assessment in that area would be equivalent to less than one per cent of market value. Another anecdotal example is outlined in Box 2, and gives a similar result. Even if such judgments about market value are reasonably accurate, they relate to only one location and variations in the assessment ratio are likely to be quite large within the province. One could not use such anecdotal evidence to infer the average level of undervaluation.

We might, also, look for evidence of undervaluation using data related to the sales of property. Declared values for land transfers are notorious for being understated in developing countries, and the degree of understatement in Punjab might tell us something about the degree of undervaluation in the case of the urban property tax. An evaluation of the stamp duty in Punjab involved comparison of the taxed value with 'indicative market value' in selected areas in Lahore district.[24] The results show assessment ratios, assessed value to market value that ranged from 55 to 79 per cent. This evidence is based on stamp duty assessments, and it is not based on a scientific survey, so it is only an indication of the degree of undervaluation for the urban property tax.

Perhaps better evidence on the degree of undervaluation in the present, 2002, valuation tables comes from comparison with the 2007 valuation table. Though the latter has not yet been released, ETD officials estimate that it would result in a fivefold increase in values for some properties, i.e. the present system is capturing only about 20 per cent of true market value in the case of those properties. Other provincial government estimates of the increase in property taxes that would result from adopting the new valuation table suggest a 180 per cent increase in values with the new roll. This implies that the average property is undervalued by about 45 per cent.

Box 2
An Example of Undervaluation

A one kanal house in Gulberg, with a covered area of 3,500 square feet is rented for Rs. 40,000 per month. Its market annual rental value is Rs. 480,000. These values are based on 'expert judgment' evidence provided by Punjab ETD officials.

According to the ETD classification, Gulberg is an A area. Applying the rates under the rented residential property category from the ETD Valuation Table we calculate the ARV of the property to be Rs. 15,815 as shown below.

Property Components	**Valuation rate**	**Value**
Land area		
First 500 square yards	4	2,000
Next 105 square yards	3	315
Covered area		
First 3000 square feet	4	12,000
Next 500 square feet	3	1,500
Total ARV		**Rs. 15,815**

Using the assessed ARV, we then calculate the ratio of the assessed value (Rs. 15,815) to the market value (Rs. 480,000) as 3.2%.

An assessment ratio[25] of 55 per cent would not be out of line with the experience in many developing countries. The ratio of assessed to market value is reported to be 25 per cent in Indonesia, and to range between 20 and 70 per cent in Kenya, 45 to 85 per cent in Chile, and 20 to 50 per cent in Mexico.[26] ETD officials also stated that even the new roll will not capture the full market value of the property. This implies that the current degree of undervaluation is well more than 45 per cent. The undervaluation is thought by some ETD officials to be greater for commercial than that for residential property.

In sum, we cannot find evidence that will allow us to name the exact degree of undervaluation. We can say that property tax revenues increased by 14 per cent in nominal terms, between the time when the 2002 tax roll came into effect and 2006. Over the same period, property values are thought to have increased at a faster rate. One service reports an increase of 36 per cent for the 2002–07 period.[27]

Some observers are interested in the possibility of self-assessment as a way of reducing assessment cost and gaining a better estimate of true market value. In fact, a number of developing countries practice self assessment. These include Indonesia, Bangalore, India, Philippines, and Hungary among others. In most cases self-assessment means reporting the physical characteristics of the property. In Columbia, however, self-assessment includes a declared value of the property and the government puts in place a safeguard against underassessment. Self assessment is not a panacea for Pakistan. It can provide additional information but in the near future, it cannot be a substitute for independent property valuation.

Revenue growth. There has been little growth in property tax revenues in recent years. The revenue-GDP elasticity is only 0.24 for this valuation period. Should we have expected a greater rate of natural increase during this period? Property tax revenues can increase for several reasons. The most obvious is an increase in taxable property values. The new valuation table was due in 2007, and is ready for implementation, but has been postponed. In the meantime, the 2002 valuation roll remains in effect. The introduction of the new table in 2007 would have led to a significant increase in revenues, though, as discussed above, it is difficult to estimate the exact amount.[28]

Even without a new valuation list, taxable property value could increase because of new construction. In fact, newly developed properties are not being brought on to the tax roll and there is no annual revenue pickup due to expanding economic activity. The ETD attributes this to the unwillingness of the TMAs to assign a tax rate to the new properties. Another side of the story that is discussed below is that TMAs, until very recently, have had little incentive to assign a tax rate in these areas.

Under the Local Government Ordinance, since 2001, all newly built up areas have been declared zero rated areas. Under the Property Tax Act of 1958, an area had to be declared 'urban' by the provincial government before ETD could carry out an assessment and levy a property tax. The Local Government Ordinance removed this step and made provisions for the TMA councils to increase the rate from zero to a positive one through a resolution. This can be interpreted in the following way: ETD can carry out assessments for any built-up area because the legal bar has been removed; but for the department to collect property tax, a TMA resolution naming a positive tax rate is required. Another provision in the Local Government Ordinance requires that 85 per cent of property tax collection should be given to the TMA where the tax is collected. However, the province did not transfer responsibility for property tax collections or revenue to the TMAs in this manner in the first years after the creation of the new local government system. This led to low credibility of the system, and certainly provided no incentive for TMA councils to pass a resolution increasing the tax rate from zero upward. By doing so, the TMAs would have earned political problems without any assurance of monies flowing into their accounts. More recently, the 85 per cent payment to districts and TMAs has been made.

Changes in the location value of properties, due, for example, to new public improvements, also, could lead to a revenue increase. However, as a matter of practice, changes in assessed location value do not occur between valuation periods. So, the structure of the property tax, and its administration, cause us to expect little revenue increase between valuation periods. A revenue-GDP elasticity of 0.24 confirms this expectation.

Tax preferences. The legal base for taxation is dramatically narrowed by exemptions and other preferential treatments. The government does not keep a record of the revenue cost of the exemptions, but an impressionistic judgment by excise tax officers is that the cost is equivalent to about 20 per cent of tax collections. This is almost certainly a very conservative estimate, given that nearly one-half of all properties in Lahore alone are outside the net. These preferential treatments also create great inequities in the distribution of property tax burdens and thereby contribute to noncompliance, and resistance to increasing the statutory rate and improving valuation.

Our estimate of the revenue cost of preferential treatments is Rs. 3.7 billion, an amount equivalent to 132 per cent of the current level of demand for collections. If the new tax roll were brought on line, the revenue cost of preferential treatments would rise to Rs. 7.6 billion. These estimates are made with the help of some simplifying assumptions, but the results suggest that even other reasonable assumptions would yield a similar result. This is an important finding if one wants to estimate the revenue potential of the property tax in Punjab. Bringing in a new valuation roll and eliminating preferential treatments alone could lead to more than a tripling of revenues.

Sticky nominal tax rates. Revenue increases also could be the result of nominal tax rate increases. However, there have been no rate increases imposed by the province since 2002. TMAs have been empowered to alter the rates since 2001, but none have chosen to do so.

Incentives for inefficient land use. The UIPT is structured to fall more heavily on improvements than on land. This is built into the system because the same tax rate is applied to square yards of land and square feet of covered area. This feature of the tax structure might be seen as discouraging efficient land use, and encouraging a less intensive use of land. This disincentive to a more efficient use of land is reinforced by the full exemption of vacant properties. At current low levels of property tax, these disincentives to more intensive land use may not matter very much, but under an upgraded property tax they would be of greater importance, (see Box 3).

Administration. Property tax records are manually recorded, in Urdu, and there is no automation in billing or in tracking collection rates. This makes an efficient collection process very costly and likely dampens the collection rate. Payment records are said to be out of date, and the matching of property tax payment with motor vehicle registration and other third party information cannot be done. A World Bank financed project is now undertaking computerization of rural land records. It aims to complete work in 8–10 years. Currently, it is not mandated to prepare computerized records for urban areas.

On the assessment side, there is little or no evaluation of the effectiveness of the process as it now operates. Three points in particular require special note.

Box 3
Taxing Land and Structures

Does this system of taxing property imply a differential tax treatment of land and improvements? We cannot answer this question directly because values of land and structures are not separately reported. If the present system does not intend to treat land and structures differently under the property tax, there is an important assumption that a 'value unit' is one square foot of land and nine square feet of structure. We can say that under the present system,

$$\left(\frac{1}{9}L+S\right)\times a = ARV$$

Where

L = Land area in square feet
S = Covered area in square feet
a = Valuation factor (location factor)

In other words,

$$\frac{1}{9}V_l + V_S = ARV$$

and

$$\frac{T_L}{T_S}=\frac{1}{9}\frac{V_L}{V_S}$$

Where T_L = the tax rate on a square foot of land
T_S = the tax rate on a square foot of structures
V_L = value per square foot of land
V_S = value per square foot of structures

Since $T_L = T_S$,
$V_L = 9V_S$

It is not clear how this equivalence was developed or justified.

If encouraging a more efficient use of land is a goal of property tax policy, which is true in some countries, a consistent structural reform would be to tax land more heavily than improvements. In the case of Pakistan, a first step toward this goal would be to tax land and improvement value equally, hence the area unit would become square feet of land plus square feet of buildings. The impact would be increased revenue, a shift in burden toward those who own more land relative to improvements, and a more progressive distribution of burdens (to the extent land owners are higher income).

First, there are no sales ratio studies, hence it is not possible to grade the effectiveness of the valuation process in estimating market value. Only anecdotal evidence and small area studies, is available regarding underassessment, and about whether the process is fair in assigning the same values to similarly situated properties. Second, the government does not systematically evaluate the impacts of the various exemptions that have been given. For example, estimates of the revenue cost of the important 5 marla exemption have not been made by the Government. Third, there is no up-to-date survey of all properties in urban areas. Therefore, the completeness of the tax roll is suspect.

Reform Options

Two basic underlying issues must be faced in property tax reform in Punjab. The first is whether this tax will become an important source of financing for government services. If a significantly higher level of revenue is to be reached, a comprehensive reform of the property tax is called for. The base and rate structure, the administration, and the intergovernmental arrangement all should be changed (The Urban Unit 2006). Coordination of these changes and a phasing in plan will necessarily be part of the reform programme. Administrative issues alone would likely require an overhaul of the law. Whether the needed fixes are politically feasible, and whether there is any incentive to adopt them, are the more important issues.

The second underlying issue is whether it will be left to local governments, city districts and TMAs, or to the provincial government, to govern the tax so as to reach the target level of revenue. This question has been answered to a considerable extent by the approval of the medium term policy framework.[29]

The framework lays down a timeline for assignment of tax policy and valuation functions to local governments, beginning with the five city districts. Simultaneously, the framework indicates addressing other policy issues.

There are a number of reform options open to the Punjab government to make the property tax more revenue productive, and arguably fairer. Some, but not all, of what we propose here has been discussed in other research reports,[30] and is also contained in the recently approved medium term policy framework.

Revenue target. The first reform decision to be taken is the revenue target for the property tax. Ideally, this will be determined with reference to the amount of expenditures to be covered by the tax, or by all own source revenue. Under the new intergovernmental arrangement, the property tax rate, and therefore the revenue target, will be set by the local councils by 2012. Until then, the provincial assembly will play a major role in determining the revenue target. In order to develop revenue estimates for the short run, we will assume UIPT to be a provincial tax with a uniform province-wide practice and a target revenue yield set by the provincial government.[31]

Valuation, revaluation, and indexing. The most obvious revenue-raising (and fairness) measure is the introduction of a new valuation roll. If fully implemented under the present rate structure, it could lead to a significant one-time increase in revenues. This could be perceived to cause enough 'tax shock' that it might need to be phased in, but it should be introduced as soon as possible.[32] The new valuation roll would lead to a revenue increase of Rs. 2.9 billion with the present tax rates and tax base and with current rates of compliance. In terms of revenue target, however, the per capita tax burden would rise only to Rs. 32, US$ 0.53. As welcome as revaluation would be, its introduction without other changes would cover only about 12 per cent of the gap between the current level of property taxes and the target level.

Base broadening measures. Revenues could be markedly increased, and the tax burdens could be made fairer, if the present package of exemptions and preferential treatments were to be significantly reduced. The reform argued here is to tax all property at the same rate, except that which is exempt by normal convention, for e.g. places of worship, charities, and that which is exempt to protect low income families. There is some question about whether the exemption of low valued properties will protect low income families from property tax overburdens. The implicit assumption made here, that low-income families will reside in low-valued premises, has not been tested in Pakistan. In addition, we can note that the exemption of low valued properties would provide administrative relief, because the assessment of such properties and collection from their tenants can be eliminated without much revenue loss.

The view here is that the temptation to use property taxation as an instrument of social or economic policy should be resisted in favour of other, more appropriate policy instruments. Let property tax policy be centred on the goal of raising a target amount of revenue in the fairest and least distortionary way possible.

We have made estimates of the revenue gains from eliminating five types of preferential treatments: The 5 marla exemption, owner-occupied preferences, the vacant property exemption, the taxation of industrial property at residential rates, and the exemption of provincial government properties.

The 5 marla lot size exemption for residential properties is arguably the most egregious of the present preferential treatments. It is difficult to see what social goal, if any, the architects of this preferential treatment had in mind in designing this exemption. Almost all reform studies of property taxation in Punjab have recommended elimination of this exemption, and most government officials interviewed have agreed.[33] The problem is, as might be expected, the political sensitivity. Even tax policy mistakes, as the 5 marla exemption clearly is, do not go away quietly once they become entrenched in the system. We have made an independent estimate, of a revenue cost of the exemption of Rs. 2.1 billion or an amount equivalent to nearly 75 per cent of the level of current demand.[34] We also estimate that under the new valuation roll, the cost of the 5 marla exemption will rise to Rs. 3.8 billion.[35] If this policy change were offset by a general exemption for low value properties, which is arguably a better way to protect the low income from heavy tax burdens, the net revenue gain would be only slightly less.

The preferential tax rates given to owner occupiers, residential and commercial, also, could be eliminated. This would yield a revenue increase of about Rs. 1.3 billion, an amount equivalent to about 50 per cent of current collections. If the preferential rate treatment were reduced so that there would be parity between taxes paid by owner occupiers and renters, the revenue gain to government under the new valuation roll would be Rs. 3.3 billion. Again, however, there is the social engineering issue and the argument made by some that the tax system should be used to encourage owner-occupancy.

Vacant properties should be brought into tax, for two reasons. First, there would be a revenue gain. Second, it would remove the disincentive to property development, that is in the present system. There are no data available on the value of vacant properties, or even estimates of the number of such properties. We assume, arbitrarily, that the value of vacant properties is equivalent to 5 per cent of the value of properties in the residential sector. From this, we estimate the revenue cost of the exemption as equivalent to Rs. 158 million, Rs. 286 million with the new roll. Note, however, that there is some question about whether the taxation of vacant land under a rental value system would be allowed under the current law.

Industrial properties should be valued separately, and should not be subject to the residential value coefficients as is now the case. Unfortunately, there are no readily available data on the number of industrial properties included in the valuation roll for residential properties. For purposes of illustration, we will make the assumption that the number of industrial properties is equal to 5 per cent of the total number of rented residential properties. We convert this to a demand for property tax payment from the industrial sector under a reformed system, using the average commercial (rented) demand per unit to estimate total taxable value. The result is an estimated revenue cost of Rs. 170 million with the new roll.[36]

Provincial government properties are also exempt from tax. Exemption is appropriate for local government properties, city district governments or TMAs, because the revenues are assigned to this level of government. Provincial and central government properties should be taxed, or at least should make a payment in lieu to recognize the value of services received. In some countries, government properties are taxed. Gujarat and Maharastra states in India tax government properties at 35 to 75 per cent of full liability depending on public services provided. South African governments are given a 20 per cent rebate against full tax liability and in Poland, government properties are taxed in the same way as are private sector properties.[37]

There are no data available on the value of provincial government properties in Punjab, hence we cannot directly estimate the revenue cost of this preferential treatment. We use the following method for purposes of illustration (see also Appendix B). We assume that the share of provincial government property in total taxable value is equal to the share of provincial government expenditure in provincial GDP. We then assume that a reasonable tax in lieu would be equivalent to 75 per cent of the full demand. The result is an estimated revenue cost of Rs. 611 million.[38]

If all of these base-broadening measures were adopted, the additional annual revenues at 2006–07 levels would be Rs. 8.2 billion. This base broadening would cover about one-third of the needed amount of additional revenues to reach the Rs. 25.5 billion revenue target.

Indexation. Another reform option to be considered is indexation. Some developing countries do try and resolve the revenue growth problem by indexing the property tax base, or rate, for inflation. Examples are Colombia, Poland, Mexico, and Nicaragua. Most countries that index are trying to deal with both the problem of revenue flatness in the period between revaluations and the problem of revenue shock when the new roll is introduced. Indexing provides some interim revenue growth and cushions the shock when the new roll is introduced. How much revenue growth in the interim period would Punjab want from indexation? We estimate that the expenditure-GDP elasticity of local governments in Punjab is 1.03.[39] For purposes of this exercise, we might set the goal for a property tax revenue-GDP elasticity of 1.0. At present, the property tax elasticity is about 0.24, so the gap is very significant.

The revenue growth issue might be addressed in one or both of two ways. First, the government might introduce the practice of indexing the tax rates in the period between revaluations. This would generate more revenue between revaluation periods, would cushion the fifth year shock associated with the mandated five-year revaluation, and would raise the GDP elasticity of the property tax.

Indexing is not without problems. The most important is that it treats all properties as if they grow in value at the same rate between revaluation periods. Of course this assumption is not true, because property values grow at very different rates depending on location and use. With indexing, these relative values are adjusted to actual market values when the new valuation roll is introduced, every fifth year. Therefore, the shock will vary from property to property. This kind of imputation in determining taxable property values between valuation periods, flawed as it is, still may be an improvement over the present system. In fact, by not revaluing for five years, the present system also does not recognize that some property values are growing faster than others between revaluation periods. Indexation makes the same error but yields more revenue and reduces the average valuation shock. It would seem a reasonable measure to consider for now, until a more suitable approach to timely valuation can be worked out.

A second approach under consideration by the government is to shorten the time between revaluation periods from five to three years. There is much to recommend this: it better captures increases in the tax base than does a five year cycle, it provides a greater flow of revenue in the long run, and it reduces the shock associated with the introduction of a new tax roll. We assume a new table will take effect in 2005–06 and that the rate of value increase is the same as that projected for the 2007 revaluation. By these data, the shock upon introducing the three year table, with no indexing, is only an 80 per cent increase in taxes, by comparison with a 125 per cent increase for the 5-year revaluation.[40]

But, there are problems with this approach. First, it can be postponed. If the 5-year cycle is postponed, why not the three-year cycle? Second, it is more costly than the five year cycle since the roll must be prepared more frequently, objections must be dealt with more frequently, etc. It takes about one year to prepare a valuation roll; hence, a three-year cycle would make the revaluation process nearly continuous.

Rate adjustments. Even with the introduction of all of these measures, a gap of Rs. 11.2 billion would still remain. The difference could be made up by increasing the nominal tax rate from the present average of about 22 per cent to 40 per cent.

One should not jump too quickly to the conclusion that a 40 per cent statutory tax rate is exorbitant or approaching confiscation level. What really matters is the effective rate, i.e. the ratio of tax paid to market rental value. A 40 per cent nominal rate translates into a much lower effective rate, depending on the assessment ratio. We have no sales ratio study to estimate the assessment ratio, but suspect from anecdotal evidence that it is quite low. Note that the combination of a 50 per cent assessment ratio and a nominal tax rate of 40 per cent yield an effective tax rate of 20 per cent on market rental value. One would not want to entertain increases in the statutory rate to such a level unless a good sales ratio study was in place. That said, the following table provides some illustrations of the conditions under which a nominal rate of 40 per cent would not be unduly burdening.

Assessment ratio (%)	Nominal rate	Effective rate
10	0.4	0.04
20	0.4	0.08
30	0.4	0.12
40	0.4	0.16
50	**0.4**	**0.20**
60	0.4	0.24
70	0.4	0.28

3. URBAN IMMOVABLE PROPERTY TAX: NWFP

The property tax is effectively a provincial government levy in NWFP (known as 'KPK' since 2010), just as in Punjab. TMAs have property taxing powers, including power to set the tax rate and power to administer the tax. They do not use these powers. Before 2001, the provincial government was required to notify an area as 'urban' in order for property tax laws to be applicable to it. Since the 2001 local government legislation, this requirement is no longer needed. All previous urban areas continue to be assessed for property tax but the remainder have been declared as zero rated areas. TMA councils have chosen not to levy the property tax in these areas.

Revenue Performance

The property tax yields very little revenue, only about 6.5 per cent of own source revenue and 0.04 per cent of provincial GDP. Surprisingly, it is used more intensively in Khyber Pakhtunkhwa (KPK) than in Punjab, in that it yields a higher per capita amount and accounts for a larger share of own source revenues (Table 2). But, as in the case of Punjab, the level of property taxation is still well below the international average. There has been some growth in revenues since the new valuation roll was introduced in 2003, both in real per capita terms and relative to GDP. We estimate the revenue-income elasticity to be 1.13 for the 2003–06 period. However, revenue flow has been very erratic during this period (see Table 2) and includes substantial collections of arrears.[41] During this period there were no changes in tax rate or valuation, so the sources of growth are additions of new properties to the tax roll, and administrative improvements which could include more vigorous efforts to collect arrears.

Base for Taxation

The UIPT in KPK is an area-based system of taxation. It is reported by provincial officials to have replaced an annual rental value system in 1997. As discussed below, there is only a very subtle but very important difference between the area-based system as practiced in KPK, and the rental value system as practiced in Punjab.

The base of the tax is the sum of land area in square yards and covered area in square feet. The implication of this method of determining the base is that more intensively used land will be taxed at a heavier rate than less intensively used land. Some would argue that good tax policy would do exactly the opposite. There is no attempt to directly value either the land or the buildings on an individual parcel basis.

Table 4
The Tax Rate Structure in NWFP
(Rupees per area unit)

Location	Residential	Commercial
A	1.5	9
B	1.25	7
C	1.0	5
D	0.75	3

Source: Excise and Taxation Department, KPK.

Tax Rates and Valuation

The different, and most problematic feature of the area-based system used in KPK is that there is no distinction between the tax rate and the tax base. The two are combined into a location coefficient, of which there are eight in the province, see Table 4. The size of these coefficients depends on the location of the property and its use. The province is divided into four location classes based on the desirability of the location, availability of amenities, etc. Peshawar city is the only place in the province with an A class location, though the city also contains properties that are classified as B and C. The determination of class location is done by field inspectors who possess knowledge of the areas, and this determination is reviewed and eventually validated by the provincial government. One might characterize the approach as being based more on expert judgment than on systematic analysis. The exercise of classification of each property according to location and use was carried out in 2001, and has not changed since. Khan points out that a formal property survey was carried out only in Peshawar.[42]

The actual tax rates, location values are notional, but appear to be an attempt to reflect both relative values and a policy choice that commercial land use should pay more property tax than residential land use. For example, note from Table 5 that a residential property in location (A) pays Rs. 1.5 per area unit, while a commercial property in location (A) pays Rs. 9 per area unit.

Table 5
Total Revenue Collections of Land Taxes: By Component
(Rupees in millions)

Years	KPK				Punjab			
	AIT	Registration	Land Revenue[a]	Stamp Duty	AIT	Registration	Land Revenue[b]	Stamp Duty
1999/00	71	11	172	142	1,217	247	2596	4,416
2000/01	23	9	177	139	672	227	2714	3,218
2001/02	47	10	200	152	556	232	2430	3,458
2002/03	44	55	250	177	623	341	3645	4,281
2003/04	58	37	292	265	768	527	4484	6,536
2004/05	47	42	375	333	615	2,186	7311	6,324
2005/06	70	42	330	300	658	2,113	3392	5,859

Source: Provincial time series data provided by the World Bank, Islamabad.

Notes:

Land Revenue in KPK includes mutation fee and land tax.

a. Land Revenue in case of Punjab includes mutation fee, some minor charges and rent from government lands.

Exemptions and Concessions

The product of base and rate gives the potential tax liability in rupees. This liability may be reduced by certain concessions:

- If the age of a property is more than 10 years, there is a 10 per cent reduction in tax liability; if more than 20 years, a 20 per cent reduction; and if more than 30 years, a 30 per cent reduction. This age test is independent of location.
- Owner-occupiers receive a 50 per cent reduction. In addition, owner-occupied properties may receive the age deduction for

their buildings. For example, an owner occupied property that is more than 30 years old will pay only 20 per cent of full tax liability.

- Properties with lot sizes less than 5 marla are fully exempt from property tax.
- No tax is levied on property owned by widows.
- There is no tax on government properties (except local government property). The interesting history here is that when UIPT was solely a provincial tax, provincial government properties were exempt, but local government properties were taxable. Now that the tax has been declared a local government TMA revenue source, the TMAs are making the argument that this situation should be reversed, i.e. TMA properties should be exempt and provincial government properties should be taxable.
- Cantonment areas levy their own property tax (and entertainment tax), and pay 15 per cent of this amount to the provincial government. Cantonment areas provide much of their own public services.

Effective Tax Rates

The underlying intent in this 'area-based' system is to assign a property tax liability to each parcel. So, we might define an *effective tax rate* as the ratio of the tax assigned to the actual market value of any given parcel. The provincial government does not make such a calculation, because there is no formal concept of market value in the new system. But, the concept is implicit to the system. ETD officers recognized that the market value of many properties has risen to a point where the effective tax rates are probably very low. However, this is only anecdotal evidence and is based on one specific area of Peshawar, so it cannot be used to infer anything about the average effective tax rate. But it does suggest how dramatic the rate of underassessment can be.

We might think more generally about the degree of undervaluation. The formula presently used in KPK calculates tax liability (TL) as the product of the locality coefficient (C) which is measured in Rs. per area unit, and the number of area units (A) which is the sum of square yards of lot size and square feet of covered area.

$$(TL) = C * A \qquad (1)$$

However, the locality coefficient (C) is implicitly the product of the tax rate (r) and the assessed property value per area unit (v). So,

$$TL = r * v * A \qquad (2)$$

Since the statutory rates of all provincial taxes have been constant for the past decade, we can assume that the hypothetical (r) would have been constant over this period. We also know that (C) has not changed since 2001, so (v) has been constant. From this we can conclude that none of the property value increase in the past 6 years has been captured in the tax base, and the only source of increase in property tax revenues has been new construction and the addition of new property to the tax roll (A), and collections of arrears. Based on this we can speculate, that the degree of undervaluation of properties already on the tax rolls is quite significant.[43]

Tax Administration

The administration of the property tax remains the responsibility of the provincial government. It involves four steps: identification of property, recordkeeping, valuation, and collections.

ID of Properties and Property Characteristics. There is a roll (registry) showing all parcels and names of owners, but there are questions about the completeness of the roll. Properties are identified by a survey, carried out once every three years and updated quarterly. The survey includes the basic information needed for property taxation: address, name of owner, land area, land use, covered area, and age of property. The present tax roll was introduced on 1 July 2005, but the basic survey work was done in 2001.

The survey was carried out by inspectors. In the old city of Peshawar, the urban area is divided into 28 zones, and each has between 5,000 and 10,000 properties, and is the responsibility of one inspector. More specifically, in Peshawar, 32 inspectors handle 190,000 properties, though it was emphasized by ETD officials that these inspectors have other tax-related jobs as well. Almost certainly, the method of determining the location values is based on a mass appraisal and relies more on judgment than on inspection. There is likely a large backlog of properties that have not yet been brought on to the tax rolls.

With respect to gathering data for valuation purposes, an estimated 5 per cent of taxpayers take advantage of an option to self-report the particulars of their property. In the case of commercial and industrial properties, there is reported to be a more detailed inspection of the property. The inspector takes measurements, interviews the owner, etc. In the case of residential properties the inspection is less detailed, owing to a shortage of qualified inspectors. Information is available on property registries dating back to 1958, so there is a basis for estimating the age of a building, land area, etc. A general impression is that the workload is large relative to the number of inspectors, suggesting that the field inspection may not be on-site for most properties.

Number of parcels. At present, there are 142,191 properties on the tax roll in old Peshawar. The breakdown is: residential (75,142) and commercial (67,049). However, the total number of assessees is only 74,908 suggesting a large amount of multiple-ownership and possibly an incomplete tax roll. The number of residential and commercial structures is heavily dominated by Peshawar district.

Numbering system. There is a unique numbering system for properties. Properties are numbered sequentially within each ward. This becomes the tax number for the property. The number may change as the characteristics of the property change, e.g. subdivision. The important implication of this numbering system is that it is unique to UIPT, and it may not be linked to any other numbering system, e.g. land registration or public utility billings, etc. Land registration numbers do not even match property tax numbers. The same numbers do not necessarily remain for the life of the property.

Titling. Apparently, most owners hold some form of deed to properties. There are reported to be few disputes on this count. Sales of property are not reported by the registration office to the tax office. It is the responsibility of the buyer to declare any change in ownership. Urban property cadastral maps are not prepared. Compared with urban areas, agricultural property in most districts is well documented with cadastral maps and unique numbering of parcels of lands.

Collection. A demand notice is delivered to each owner by a constable. Payment may be made at the bank, and there is a 10 per cent discount for early payment. A follow up notice is sent to those who do not pay. The Government can arrest non-payers (provincial officials reported that 400–500 property owners were arrested in 2006), and it can seize property. Khan however, notes that the local police in KPK are generally non-supportive in honouring ETD arrest warrants.[44]

The estimated collection rate in the Province is about 60 per cent.

Problems with the Present System

The major issue to be addressed with property tax policy in KPK is the need to raise the level of property tax revenue. The collection in 2006 was about Rs. 14 per capita, US$ 0.23, which is a very nominal amount when compared with per capita provincial government expenditures of Rs. 4,086. There are two reasons why the currently low level of revenue is problematic. First, there is a need for more revenue to cover service level deficiencies in the province. Second, local residents/voters need to see a more meaningful match between the burden of taxes they pay and the quality of services they receive, if the decentralization strategy is to work in Pakistan. A property tax burden equivalent to 0.04 per cent of provincial GDP will not address either problem.

A major constraint to a more productive property tax in KPK is the undervaluation of properties, which limits the yield of the tax, and the absence of a mechanism to allow growth in this base. Some method must be found to provide for an annual growth in property tax revenues. At present, there is no provision for regular revaluation of properties and tax rates have been, implicitly, held constant. There has been some growth from new properties being brought on to the tax rolls and from collections of arrears, but none of the post 2001 increase in values for properties already on the roll has been captured. There has not been a survey/recalculation of location values since 2000, and even that was done only in Peshawar. This means that the measurement of built-up areas, land use, and the condition of the surrounding infrastructure are all based on outdated information.

There are major exemptions from the taxable base. Significant preferential treatment is offered to owner occupiers, industrial properties, and vacant plots. And, as in Punjab, there is a tax exemption for properties having a plot size of 5 marla or less. These preferential treatments impose a significant revenue loss. Our estimate is that the loss due to all tax preferences is about Rs. 611 million, which is equivalent to more than 100 per cent of actual collections in 2006. This and an outdated valuation roll go a long way toward explaining the weak revenue performance of the property tax in (KPK).

Finally, there are problems associated with the intergovernmental arrangement for levying the property tax. In theory, the TMAs are empowered to levy the tax and choose the rate. In fact, the province has assumed this responsibility, and the TMAs seem to have willingly ceded their powers. More to the point, local governments in KPK have lobbied the provincial government on behalf of their constituents for lower property valuation classifications.[45]

Reform Options

An underlying problem is that there is a need for KPK to rethink the rate and base structure of its property tax. The tax liability per area unit of a property is all that is reported in the valuation table. As noted above, however this coefficient is, implicitly, the product of a nominal tax rate and a valuation.[46] A first necessary reform is to make explicit the separation between tax rate and tax base. This separation needs to be made explicit for several reasons:

- Responsibility for rate setting could be assumed by city district government and TMAs before valuation responsibilities are handed over. This could not be done under the present regime.
- Good property tax practice requires a separation between valuation, a technical matter, and rate setting, a political matter.
- Monitoring of the accuracy and fairness of property tax assessment practices requires regular sales-assessment ratio studies. These would require separate data on property values per area unit.

We might use the same procedure as in the Punjab case to define a target for property tax revenue enhancement in NWFP. If we use the international average for less developed countries of 0.5 per cent of GDP, the target for 2006 would have been Rs. 3.6 billion, or an implied increase of about 10 times the present level. The reform question becomes whether there are options available to upgrade the property tax to this extent.

Revaluation. The first problem to be addressed is to build into the system a method to capture property value increases, vs. increases in area. This should be followed by a general revaluation, or in the KPK case, a revision of the valuation table. At present, the KPK government has no plans to construct a new table.

There is no solid empirical basis for estimating the revenue increase that would follow a revaluation, e.g. data that show increments in market value over the past decade. We can offer only a hypothetical example of how revaluation might affect the property tax base. We do this by noting that the increase in assessed value in Punjab was estimated to be by a factor of 1.8, suggesting an 80 per cent increase in property values between

2002 and 2007. To illustrate the potential effects of revaluation in NWFP, we have used a factor of 1.5, the lower factor to suggest the lower level of income in NWFP.

Base broadening. A second set of reforms would focus on base broadening. We estimate the revenue gain from the following changes in the present exemption package, using exactly the same methodology that was followed in the case of Punjab.

- Eliminate the 5 marla exemption.
- Eliminate the tax preference for owner occupiers.
- Tax vacant properties.
- Tax industrial properties at commercial rates.
- Payment in lieu of tax introduced for provincial government properties.

Indexation. To address the problem of building some natural growth into the property tax base, we evaluate two reform options. First, we have indexed the tax rate by the, one-year lagged, general rate of inflation. Over the 2002–03 to 2005–06 period, the province would receive a total of Rs. 127 million in additional revenues (3 years total), 83 per cent of the 2002–03 total.

The second possibility for growth enhancement is the introduction of a three year valuation cycle. Using historical data and assuming general revaluations in 2002–03 and 2005–06, we show that between general revaluations the government would have gained Rs. 60 million in additional revenues, 39 per cent of 2002–03 levels, and faced a tax shock of 41 per cent in 2005–06 revaluation year.

Rate adjustments. The estimated effect of these changes in property tax structure is to cover about Rs. 2 billion of the estimated revenue gap of about Rs. 3 billion. How could the remainder be made up? In the KPK system, this might be done by further increasing the location values. Assuming a 75 per cent collection ratio, we estimate that the 'location factors' will need to be increased by two times to bridge the revenue gap.[47]

Administration. Even with a more rational structure of UIPT, revenue enhancement will be held back because of the presently poor state of property tax administration. A major need is to upgrade the skills and size of the staff that assess and collect UIPT. Khan (2004), after study of the UIPT administration in NWFP, makes the point that Peshawar has over 115,000 property units and that these cannot be managed by the present ETD staff. Arguably the greatest needs are to invest in surveys that will allow records of the various tax bases to be updated, and to begin moving recordkeeping away from the present manual system toward an automated system. This is discussed in more detail in Khan.[48]

4. COMPREHENSIVE STRUCTURAL REFORM: UIPT

The UIPT is not yielding very much revenue, and it is failing in its non-fiscal objectives. This suggests that it could be a good time for both provinces to overhaul the entire structure of the tax. Structural reform will be more difficult at a later time when the level of the tax is higher. In the analysis above, a revenue 'target' for the property tax in Punjab is set at Rs. 25 billion at 2006/2007 levels of the tax. The target for KPK is set at Rs. 3.6 billion. This would bring both provinces to the international average, but it also would imply a dramatic increase in property tax revenues. We would propose that this increase be obtained from four measures. The following actions might be taken.

First, bring in the new valuation roll in Punjab, which assesses market rental value and puts the correct relative values on properties. In NWFP, put in place a formal structure that calls for periodic revaluation and begin construction of a new valuation roll.

The second step is to broaden the base of the property tax in both provinces. The numerous preferential treatments in the present system should be eliminated or rolled back and preferences should be limited to low valued properties. This would include eliminating the 5 marla exemption and the preferential treatment of owner occupiers. It also would require that provincial government properties make a payment in lieu of property tax for services received. Vacant properties would be taxed, and industrial properties would be moved to the commercial valuation table. If these base broadening measures were all introduced at once, on the new valuation base, they would bring in Rs. 7.5 billion in Punjab, and Rs. 1 billion in NWFP. Even without the introduction of a new valuation roll, this is equivalent to 125 per cent of current collection in Punjab and 50 per cent in NWFP.

Indexation would bring in another Rs. 827 million in Punjab and Rs. 78 million in NWFP, leaving gaps of Rs. 11.2 billion and Rs. 2.1 billion, respectively. These gaps might be filled by increasing the nominal tax rate. We also propose that a single tax rate be adopted in Punjab. There is no justification for an additional higher rate, because superior amenities, etc. have already been accounted for in the valuation of the property.

In addition, the taxation of land and improvements should be brought to the same basis, i.e. the tax base should be the number of square feet of covered area plus the number of square feet of land area. Since this involves increasing the tax on land relative to that on buildings, it will lead to an additional revenue increase. Data are not available to estimate the magnitude of the revenue increase.

Intergovernmental reform. The provincial government in Punjab has adopted a medium term framework that will move it toward the assignment of property tax policy and administration to local governments.[49] In the interim, it should implement the legal tax sharing arrangement with local governments. There are strong arguments to make the property tax a local government revenue source, with the TMAs having rate setting powers and some degree of administrative control, as announced in the policy framework. While this is the present legal arrangement for the property tax, de facto it is not yet the practice in either province. It would be useful to revisit the benefits of the legal arrangements laid down in the 2001 local government ordinance, and to begin implementation, for the following reasons:

- This will permit a stronger link between property taxes paid and local public services received.
- Taxing powers will make elected local officials more accountable to the voters for the quality of local public services delivered.
- Local officials have greater familiarity with the local economy, hence a comparative advantage in some areas of tax administration, e.g. identification of properties for the tax roll.

There are also disadvantages to adopting this intergovernmental approach; and concerns that might be raised about the potential success of the medium term framework. First, local governments already have the authority to set the tax rate and to administer the tax, and they have chosen to do neither. Why will things be any different under Punjab's medium term framework, and why might things change in NWFP? Second, some local governments may not be technically up to the job of property tax administration. This could result in a long transition period. The first challenge in structuring the reform programme and implementing it would be to get around these disadvantages.

As a first step, the provincial governments could move toward a redefinition of certain of their intergovernmental practices.

- So long as the provincial government remains involved in collections, it should notify each local government of its revenue entitlement, the amounts collected in its area. This should be done on a timely basis so as to assist local government cash flow planning during the fiscal year.
- No intercept from property taxes should be allowed for utility payments. If there are to be intercepts, they should come from the general grant to local governments. To intercept from property taxes weakens the perception of the linkage between property taxes paid and local public services received. In fact, the practice of intercepts for utility payments has recently been discontinued.

Because of the deficiency in local public services, a reasonable goal of government might be to increase the effective rate of property taxation. But local governments have not been willing to use the rate setting powers that they now have. The alternative, transfers from the province, are 'easier' money in that they have little political cost to local politicians. This is the mindset that must be broken if decentralization is to succeed. One way to do this is to provide a significant incentive for local governments to increase the level of property taxation. The province might attach a tax effort feature to its grant programme to try and coax this increased property tax effort out of the local governments.

There is also the issue of who should administer the property tax. There is a strong, a priori, case for local administration and there is a legal basis for this. This is the long term plan under the new framework in Punjab and presumably it is the plan in NWFP. However, there is a question of administrative capacity at the district and TMA levels. This leaves three options:

- Divide responsibilities along functional lines, for example, leave preparation of the valuation table and recordkeeping with the province, but let the local government be responsible for collections and for identification of new properties to be added to the tax rolls.
- Let the local governments assume further administrative responsibility when they demonstrate readiness, as measured by some objective benchmarks.
- Let the tax administration be led by the province, but allow the local governments to set the tax rates, perhaps above some minimum.

All of these reform options would increase the revenue importance of the UIPT.

5. LAND REVENUES: LAND AND PROPERTY TRANSFER TAXES

The Board of Revenue (BOR) is responsible for assessing and collecting rural land taxes and charges, the agricultural income tax, and all property transfer taxes. The tax administration set up is the same in both KPK and Punjab. Most revenues collected by the BOR come from taxes on property transfers in urban and rural areas. There are also a number of fees/charges that add up to a significant amount of revenue. There is no annual tax on land that is collected by the Board of Revenue in Punjab.[50] There is however, an annual tax on agricultural land in NWFP. In both provinces, there is an additional tax on property transfers that is collected by the local government, and is not covered in this report. The following table shows the tax rates for the four different taxes levied on a property transfer:

(Rates as % of value)

Tax	**NWFP**	**Punjab**
Stamp Duty (Province)	3	2
Registration or Mutation Fee (Province)	2	1
Capital Value Tax (Federal)	2	2
Tax on Transfer (Local)	0.5	1
Total	**7.5**	**6**

Revenue Performance

Board of Revenue collections of land revenues in Punjab and KPK, shown in Table 2, accounts for less than 1 per cent of GDP in both provinces, and are much lower in KPK than in Punjab. In light of the fact that agriculture accounts for about 27 per cent of provincial GDP in Punjab and 30 per cent in NWFP, this is a surprisingly low revenue share. Even when account is taken of the share of subsistence farming, the revenue contribution seems low.[51] Neither has the revenue trend been impressive.

Land Taxes per hectare of Cultivated Land (2005–06)

(in rupees)

Taxes	**Punjab**	**NWFP**
Agriculture income tax	25.83	17.09
Registration fee	82.90	10.25
Land revenue	133.09	80.57
Stamp duty	229.90	73.24
Total	**471.73**	**181.15**

Table 6
Revenue Performance of Land and Property Transfer Taxes

6.1 AIT

Years	Per capita Nominal Amount (Rupees)[a]		Per capita Real Amount (Rupees)[a,b,c]		% of Own Source Revenue[a]		% of GDP[d,e]	
	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab
1999–2000	3.85	15.33	3.85	15.33	2.71	7.33	0.020	0.057
2000–01	1.20	8.27	1.10	7.64	0.87	3.87	0.006	0.028
2001–02	2.46	6.68	2.22	6.03	1.54	3.40	0.012	0.022
2002–03	2.25	7.32	1.94	6.33	1.44	3.27	0.010	0.022
2003–04	2.87	8.82	2.30	7.08	1.54	3.23	0.011	0.024
2004–05	2.27	6.90	1.70	5.18	1.13	2.13	0.008	0.016
2005–06	3.31	7.22	2.27	4.96	1.53	2.23	0.010	0.015

6.2 Registration

Years	Per capita Nominal Amount (Rupees)[a]		Per capita Real Amount (Rupees)[a,b,c]		% of Own Source Revenue[a]		% of GDP[d,e]	
	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab
1999–2000	0.58	3.12	0.58	3.12	0.40	1.49	0.003	0.012
2000–01	0.47	2.80	0.43	2.59	0.34	1.31	0.002	0.010
2001–02	0.54	2.79	0.48	2.52	0.34	1.42	0.003	0.009
2002–03	2.81	4.01	2.43	3.47	1.80	1.79	0.012	0.012
2003–04	1.83	6.05	1.47	4.85	0.98	2.21	0.007	0.016
2004–05	2.03	24.52	1.52	18.40	1.01	7.57	0.007	0.058
2005–06	1.98	23.17	1.36	15.91	0.92	7.14	0.006	0.048

6.3 Land Revenue[f,g]

Years	Per capita Nominal Amount (Rupees)[a]		Per capita Real Amount (Rupees)[a,b,c]		% of Own Source Revenue[a]		% of GDP[d,e]	
	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab
1999–2000	9.35	32.71	9.35	32.71	6.58	15.63	0.049	0.121
2000–01	9.40	33.40	8.69	30.87	6.84	15.63	0.047	0.114
2001–02	10.36	29.21	9.35	26.38	6.51	14.86	0.049	0.096
2002–03	12.64	42.80	10.93	37.02	8.12	19.13	0.055	0.131
2003–04	14.44	51.47	11.59	41.32	7.77	18.84	0.056	0.138
2004–05	18.12	82.01	13.60	61.52	9.05	25.33	0.061	0.195
2005–06	15.59	37.19	10.71	25.54	7.19	11.47	0.045	0.077

6.4 Stamp Duty

Years	Per capita Nominal Amount (Rupees)[a]		Per capita Real Amount (Rupees)[a,b,c]		% of Own Source Revenue[a]		% of GDP[d,e]	
	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab	NWFP	Punjab
1999–2000	7.71	55.63	7.71	55.63	5.42	26.59	0.040	0.206
2000–01	7.38	39.60	6.83	36.59	5.37	18.53	0.037	0.135
2001–02	7.89	41.56	7.13	37.54	4.96	21.14	0.037	0.137
2002–03	8.96	50.28	7.75	43.49	5.76	22.47	0.039	0.154
2003–04	13.10	75.02	10.52	60.23	7.05	27.46	0.051	0.202
2004–05	16.09	70.94	12.07	53.22	8.03	21.91	0.054	0.169
2005–06	14.17	64.24	9.73	44.12	6.54	19.81	0.041	0.133

Sources:

Calculations are based on:

a. Provincial revenue time series data provided by the World Bank, Islamabad.

b. NIPS population data.

c. FBS GDP deflator.

d. Punjab GDP estimates from Punjab Bureau of Statistics.

e. KPK GDP estimate from Government of KPK (2007a).

Notes:

f. Land Revenue in KPK includes mutation fee and land tax.

g. Land Revenue in case of Punjab includes mutation fee, some minor charges and rent from government lands.

The level of collections of land revenues are shown by major type for Punjab in Table 6. The results of this disaggregation reveal that stamp duties, mostly collected from property transfers, are the major revenue component of taxes collected by the BOR. Taxes on property transfers also include a mutation fee or a registration fee. Liability for each of these taxes depends on the type of property being transferred, and to some extent on the choice made by the taxpayer.[52]

The total amount of revenue collected from each form of property transfer tax is reported in Table 7.[53] The stamp duty on property transfers yielded about Rs. 7.8 billion in Punjab, i.e. about 20 per cent of own source revenues in 2006–07. In recent years, the nominal tax rate has been lowered in an effort to increase compliance. None of these tables reports collections of transfer tax by local governments, or the federal government capital value tax on property transfers.[54] Only provincial government revenues are shown in Tables 6 and 7.

Table 7

Disaggregation of Provincial Government Land Taxes by Component for Punjab (2005–2006)[a]

Tax	Per capita collection (Rs.)	Per cent of GDP	Per cent of Land Taxes[b]
Stamp Duty	83.89	0.13	49.78
Mutation	41.5	0.08	24.64
Registration	24.4	0.05	14.47
Agriculture Income Tax	16.05	0.02	9.53

Source: Government of Punjab (2007d).

Notes:

a. Excludes federal capital value tax and local government tax on transfer of property.

b. Land tax total includes stamp duty, mutation, registration, and agriculture income tax.

Table 8
Collection by Type of Provincial Government Property Transfer Tax[a]
(rupees in millions)

Land Taxes	Punjab[b]	NWFP[c]
Agriculture Income tax	1,493	70
Land Revenue	249.0	421[d]
Mutation fee	3,861	–
Registration fee	2,267	47
Stamp duty	7,802	285

Notes:

a. Excludes federal capital value tax and local government tax on transfer of property.
b. The Punjab collections are from Government of Punjab (2007b).
c. The KPK collections are from Government of KPK (2007b).
d. The classification in this case is not clear; it may include mutation fee.

Mutations and Registrations?

There are two forms of property transfer: 'mutation' and registration, Box 4. A mutation involves a transfer of property when there is a record of ownership, but not necessarily a deed. This is the form of transfer used in rural areas where much of the land has been inherited. Registration is used mostly in urban areas where in general there are no comprehensive records of ownership. Regular or organized land records do not exist in most urban areas. There are no *patwaris* for the urban areas and a mutation register is not maintained. Registration transfer is the only option for most urban purchasers. In other cases, where land records exist, e.g. rural land and in one part of Peshawar old city, registration is preferred because it gives a stronger title, since a registered deed has a presumption of truth attached to it under the evidence laws. Legally, the same presumption is attached to mutations, but due to deterioration of land records, the courts may call for additional evidence and do not always accept a certified mutation as a sufficient basis for establishing ownership.

Box 4
Mutations and Registrations

> Mutation is applicable primarily to the transfer of agriculture land. For a mutation, the transfer is reported to the *patwari* who enters it in the mutations register where he notes the reference in the record-of-rights and the number of the parcel. The mutation is then certified in a public gathering by the *tehsildar* when he visits the *patwar* circle. In general this happens once a month. Upon certification by the *tehsildar* in the mutation register, the transfer becomes final. The *patwari* then makes a red ink entry in the records-of-rights register. This entry forms the basis of changes in the ownership column of this parcel of land when the next edition of the record-of-rights is prepared. The editions are prepared every four years. Mutations are carried out for all forms of transfer, including inheritance, sale or in compliance with a civil court decree. The tax treatment varies by type of transfer.
>
> Registration, applies mostly to urban property, for which the records-of-rights do not exist. For registration, the transfer deed is prepared on a stamped paper and attested to by the registrar of properties. The registrar maintains a record of the deeds but there is no comprehensive record of properties in most urban areas. If a person wishes to carry out registration for agricultural land, he is allowed to do so as an additional step after the mutation.

Tax base: rural properties. Technically, the base of the property transfer tax is the market value of the property transfer. In practice, it is not completely clear how the transfer is valued for purposes of tax. The process in rural areas in Punjab is described to be as follows: The buyer and seller make a declaration of the value. The *patwari* is consulted about the 'reasonableness' of this declaration. The law provides for a right of pre-emption, i.e. neighbours may buy the land for a price higher than the stated declaration. These checks, in theory, will lead to a proper self-declaration of land value. However, experience tells us that it cannot be assumed that pre-emption is costless, or that there will not be collusion among neighbours, therefore pre-emption may not be invoked in many cases.

Resort to the *patwari* to check on the reasonableness of declared value is not likely to be effective for a number of reasons. One of these reasons is that the claims on the *patwari*'s time, e.g. court appearances, may preclude the possibility of his doing the necessary research. The result is that undervaluation is thought to be very common because the declared selling price is usually accepted as the base of taxation.[55]

The method used is somewhat different in NWFP. The base for the tax is not declared value but a notional value that is drawn from a table of estimated market values for lands in different locations. This table is certified by a Committee. The Committee is chaired by the Collector and its membership includes the Executive District Officer of Finance and the District Officer of Works and Services. The latter will provide inputs on value-enhancing developments in different zones. In fact, the valuation table is an average of the declared values in the past year, for each type of land. A similar table is prepared in urban and rural districts. There is an ample number of transfers to calculate an average value. In Punjab, the collector formulates a valuation table for urban areas only.

In neither province is there a sales ratio study to enable an estimate of undervaluation. Such studies usually require independent appraisals of market value. The only supporting evidence prepared for rural areas in Punjab, and for urban and rural areas in NWFP, is the *ausat yaksala* which is an average sales value for different types of land in a recent period. In both provinces, this document is prepared by the *patwari*. It is not thought to give a reliable estimate of full market value.

Tax base: urban properties. A valuation table is used for land in urban areas in both provinces. The valuation tables are prepared by the district collector, who is head of the land revenue department. He is empowered by law to carry out any survey or adopt any means necessary to do the valuation.

In theory, these values are based on a combination of subjective, expert judgment and objective price information. They are updated regularly. In practice, the approach may be more ad hoc. In Punjab, the land values in the table are reported to be the same as those laid down in the Wealth Tax Act of 1963 (repealed).[56] This suggests little by way of a regular updating. Moreover, the table does not include the value of structures.

Available evidence suggests that properties are undervalued, but there is no good evidence of the extent of this undervaluation. One non-scientific, survey of 11 selected areas in Lahore district came to the conclusion that the assessment ratio against market value varied from 55 per cent to 79 per cent.[57] We can find no such evidence in rural areas. In neither province is there any coordination between the Board of Revenue in its land valuation process, and the ETD in its urban property tax valuation process. This would seem to be a missed opportunity.

Tax rates. Property transfers are subject to an array of tax rates and special fees. A Rs. 200 fee is applied to any mutation. Transfers by inheritance and those transferred under court decree pay only this amount. Otherwise, mutation transfers and registration transfers are subject to a 1 per cent registration tax in Punjab and 2 per cent in NWFP, and a 2 per cent stamp duty on the value of the transfer in Punjab and 3 per cent in NWFP.

A local transfer tax of one per cent is collected separately by the TMA in Punjab. In KPK the local transfer tax rate is 0.5 per cent.[58] In addition, there is a 2 per cent capital value tax levied by the central government.

Land records. There are detailed records of land ownership, land characteristics and land use in the rural areas. They are maintained by the *patwari*. All districts in Punjab and most areas in KPK have these records. Areas which have these records are called 'settled'.

By contrast, records are not very good on the physical characteristics of properties in urban areas because these properties have never been surveyed. The degree to which this is a problem varies by type of urban area. Urban areas are of various kinds: (i) those which are old urban settlements; (ii) those where urban growth has sprawled into rural areas; (iii) urban localities developed by development authorities; or (iv) urban areas developed by private developers. The state of property records differs among these property types. For (i), in some cases, old records are available. However, in cases where these are available they are not up to date and often have only a historical value. In the case of (ii) the *patwari* records are available and may or may not give good evidence of the current status of the property. Development authority properties (iii) have reasonably complete records which were prepared at the time of their development. All parcels of land are numbered and the original allottees or buyers are recorded. However, development authorities do not update the records after the first transfer of ownership to the buyers. For (iv) records are not fully developed and are not up to date. All four categories of land may exist in notified urban areas.

In the absence of any formal property records, the PT-1 register of the excise tax department is the only record of these properties that might give evidence of ownership. However this fiscal register does not give any *proof* of ownership. At best it provides corroborative evidence. Preparation of comprehensive land records for the urban areas is an important task that remains to be completed.

Stamp Duty

The base for stamp duty includes virtually all kinds of transfers and legal documents. For example, more than 120 items are subject to stamp in NWFP. The stamp duty rates vary by type of document, but most revenue is collected from stamps on property transfers. The Province has proposed a new schedule of stamp duty rates, but it is not clear that this revision will be accepted. Stamp duty reform has also been under discussion in Punjab. The proposed reform includes a reduction in the tax rate on property transfers, per an ADB recommendation.[59] In Punjab, the stamp duty rate is 2 per cent on the value of property transfers. This is in addition to the 1 per cent registration fee, 2 per cent CVT and 1 per cent local rate. Hence the total rate paid on a property transfer is 6 per cent (7.5% in NWFP). Approximately 75–80 per cent of stamp duty revenue is from property transfers in Punjab.

Other Land Taxes in NWFP

While the system of mutation, registration, and stamp duty is much the same in the two provinces, there are some differences in terms of additional taxation of land imposed in NWFP. *Ushr* is essentially a contribution collected by the BOR. The funds are turned over to the district Zakat account, which is managed by a committee appointed from within the district. The committee allocates the money among welfare projects and assistance to the needy. The *Ushr* revenue is not included in the Provincial Government budget.

The base of the tax is the volume of the produce of a farm. The assessment may be made at the farm gate. The tax rate is 10 per cent for unirrigated or *barani*, rain irrigated, land, and 5 per cent in the case of irrigated land. Irrigation can be by tube well, canal or any other means, the lower rate of tax is meant to reflect the cost of irrigation. Exemptions from the tax are for land that is not cultivated, and for farms producing less than 1,000 kilos of wheat. The exemption does not apply to cash crops. Those following Fiqh Jafaria are given an exemption from paying *Ushr*. Revenue collections are reportedly weak by comparison with revenue potential. Some observers take the view that major administrative improvements and monitoring are required.

Payment may be in kind. The government agent may collect the payment, for example of wheat, at the time of threshing. The government then sells the produce and passes the money to the Zakat Department. In practice most of the collection is in cash. There may be a compliance problem. It was noted by provincial officials that collection was difficult other than for grain products. The difficulties in collection are compounded by the high rate of tax which contributes to lowering voluntary compliance. Revenue from *Ushr* in 2002/03 was Rs. 1.7 million.

Khyber Pakhtunkhwa also imposes a *land tax* which is general revenue in the provincial government budget, but is a minor revenue source. The base of the tax is the area of land owned. The tax rate is Rs. 50 per acre for irrigated land and Rs. 25 for unirrigated land up to 12.5 acres. Irrigated farms of 12.5 to 25 acres in size are taxed at a rate of Rs. 72 per acre. The rate is Rs. 100 per acre for farms larger than 25 acres. The rates for unirrigated land are one-half of the rates for irrigated farms. Orchards are taxed at Rs. 300 per acre. Land tax is levied on cultivated land only. Uncultivated land is exempt.

Only farmers with ownership of less than 5 acres in a revenue estate are exempt. The tax liability is worked out on the basis of a person's ownership in one revenue estate. Ownership of land in another jurisdiction will not cause a land owner to be bumped to a higher tax bracket. This provision is by default, because the land records are not interlinked. Until they are, there is no way to fully capture the tax base.

Water Rates

These revenues are transferred by the province to the districts on a derivation basis. Water rates are assessed by the provincial irrigation department, but are collected by the village headman on behalf of the BOR. The village headman is supported by the *patwari*. Presently, the Board of Revenue in Punjab has assigned *patwaris* to work directly under the irrigation department to solve the inter-departmental coordination issues. Estimated revenue collections are about Rs. 5 billion, even though collection rates are only about 60–65 per cent of amounts due. The department also collects a local rate which is Rs. 2 per acre on all types of agricultural land.

Determination of the use of water is linked to crop types, which in turn is deduced from the *patwari*'s crop inspections. Better quality inspections can help determine the usage more accurately. The rate structure should also be reviewed with an eye toward increasing revenue from this source.

Problems and Issues

About 27 per cent of province-wide GDP is generated in the agricultural sector in Punjab and 30 per cent in NWFP. Anecdotal evidence in Punjab suggests that both urban and rural property values have increased considerably in recent years. However, revenues from the various land taxes are not keeping pace with either inflation or GDP, Table 6.[60]

The problem is that property transfers are not being taxed at their market values, as is called for in the law. The only objective evidence used in the valuation process would appear to be the averages computed by the *patwari* for rural areas. But since this is an average of stated or declared values, it is almost certainly much below the true market value. In compulsory land acquisition cases, the courts have routinely refused to accept the annual average value worked out from *patwari* records and have awarded higher compensation to land owners. A Supreme Court judgment in the 1990s ordered that government should pay on the basis of market values instead of on the *patwari*'s *ausat yaksala*.

Neither is there confidence that the urban area valuation tables recognize full market value. These tables are prepared by the collectors but apparently are based on no more accurate data base. The opinion of those government officials interviewed is that the valuation tables represent only a fraction of market value and are not based on an adequate survey. Officials from the provinces speculate that taxed values are probably in the range of 25–50 per cent of true values, and much less in the case of new development areas. The property values assessed on the basis of the valuation table in Lahore were estimated to range from 55 per cent to 79 per cent of the corresponding market values.[61]

The upshot of this situation is that the transfer taxes are yielding only a fraction of their revenue potential at current rates. Since sales ratio studies are not carried out, the true coverage of the tax base is unknown.

A second problem is that the tax base has been narrowed by exemptions, sometimes given for political reasons and sometimes given for reasons of administration. Officials in KPK offered the following list of issues, but much of this would be applicable to Punjab as well.

1. Large tracts of land in some districts have not been 'settled', which means that detailed records for them have not been prepared. They remain outside the tax base.
2. PATA districts in KPK are largely outside the land tax base because of their legal status. The tax laws have not yet been extended to cover them.
3. Small farms are exempt. Due to subdivision of land, through inheritance, the base is shrinking.

The tax base is narrowed for administrative reasons as well. In rural areas, the *patwari*'s office is overburdened with duties which do not relate to tax collection. He does not have the staff, office or mobility. He is dependent on local support for performance of his official duties, see Box 8. The result is significant delay in recording property transfers and collecting due taxes.

Third, there is a significant problem with record keeping. An updating of the 'record-of-rights' is required every fourth year. But in many instances the records are not updated on time. The Government of Punjab reports the records in Lahore to be twenty years out of date.[62] Organized records for land in urban areas do not exist. The quality of records also leaves much to be desired. Reportedly, errors in records have contributed significantly to civil litigation.

Are the Basic Tax Instruments Adequate?[63]

Underneath this questioning is the concern about whether the present regime is the most suitable for Pakistan. In raising this question, we might look to the international practice. Stamp duties are a part of the tax system in most countries, but they are widely criticized. The fundamental question to be addressed in Pakistan, and elsewhere, is 'why have a stamp duty?' Clearly, there is need to legalize documents and assure that they are properly filed, and a government stamp is one way to do this. To levy a service charge that would cover the stamping and verification cost would seem a reasonable justification. There might be some justification for differentiating the rate of charge by type of document, given the different degree of examination required for various types of documents. The problems arise with respect to property transfers, such as the regime that includes stamp duty, mutation fee, and registration fee, in Pakistan.

There are a number of reasons why real estate transfers have found their way into tax systems in many developing countries, including Pakistan. First, it is an easy tax handle in that most buyers/sellers desire to legally record the transfer, and therefore will voluntarily comply. Second, the revenue motivation and what might appear to be a very low cost of collection. When property values escalate, as happens periodically in most countries, the revenue take can be quite significant. Third, if property ownership is concentrated in the higher income classes, the distribution of tax burdens may be progressive. Fourth, the number of people in the taxpaying population in any given year is much smaller than in the case of more general taxes, hence the opposition to the tax may not be as great as would be the case if, say, an increase in the value added tax were proposed. Finally, a property transfer tax might reach that part of the population that ordinarily avoids payment of most income tax and value added taxes.

There are major disadvantages to the property transfer tax. First, it raises the cost of property transactions thereby reducing the volume of transactions, hence slowing the development of the real estate market. Second, if the tax is properly assessed, administrative costs could be high, at least because of the need to check the self-reported property values and revalue when necessary. Third, a property transfer tax gives property owners an incentive to understate taxable value, hence weakening the database that is called on for assessment of the urban property tax.

A moment's reflection will lead to the conclusion that the problems with the property transfer tax are dependent on the level of the nominal tax rate chosen. At very low rates, these problems may be of less consequence. But when the tax rate is high, the implications of these problems are magnified.

In fact, countries choose very different rates of taxation on the value of property transfers. An illustrative list of rates for various countries is shown in Table 9. These data suggest a great deal of variation in the practice. South Africa, for example, taxes property transfers and also subjects these sales to a 14 per cent VAT. But in many countries, the rates are below those levied in Pakistan. The reform options most often seen for property transfer taxes in recent years are reductions in the rate to mitigate the problems described above. Examples include Czech Republic in 2003, Portugal in 2003, Slovakia in 2002, Taiwan in 2003, and Dominican Republic in 2003.

Reform Options

The primary, short-run reform goal of provincial tax reform is to increase revenues to finance services. This should be done by rationalizing the system of taxation so that the revenue flow is adequate to meet the revenue target, the tax burdens are fairly spread between urban and rural residents, and undesirable behavioural effects are avoided. Simplification in the tax structure should be sought, especially given the limited administrative capacity of the provincial government. This is the context in which we consider reform of the present system of land taxes.

An obvious change is to collapse the three different provincial property transfer taxes into one levy. This would simplify the tax regime and make it more transparent and manageable. Initially, the tax rate could be set at the present, aggregate, level.

In the short run, some will argue for an increase in property transfer tax rates as a revenue enhancement measure. This might be done by simply raising the rate, or by indexing the existing rates to some indicator of average property value growth.[64] This is not a good solution to the revenue problem, and it is not good tax policy, because it ignores the underlying valuation problem and might even exacerbate it. Higher rates would provide even more incentive for under-declaration of values. The alternative route, indexing, would penalize properties that experienced slower growth in favour of those experiencing faster growth. The goal of developing the real estate market would also be thwarted.

Others will argue to lower the tax rate so as to encourage compliance. It would be reasonable to conclude that lower rates would improve compliance, but we have no hard evidence on the extent of the response. Reportedly, some local governments in Punjab realized an increase in compliance after lowering the tax rate. However, only anecdotal evidence on this experience is available.

There are no reliable sales-ratio studies available, but anecdotal evidence suggests that a 50 per cent undervaluation of transferred property might be a reasonable estimate.[65] In this case, a 15 per cent increase in taxable values, and tax collections, would be well within the reach of provincial governments if they chose to make the necessary administrative improvements. This would yield an additional Rs. 1.7 billion in collections in Punjab. In KPK, it will yield an additional Rs. 100 million. Some observers would place the degree of underassessment at a greater level, perhaps 70 per cent. In this case, our proposed 15 per cent increase in values underestimates the revenue potential from revaluation, even taking into account the political considerations that would dictate 'going slow'.

A more comprehensive reform of the taxation of the rural sector might pull back from taxing property transfers altogether. The rationale for this proposition is straight forward. Provincial taxes might be seen as a payment for public services received. It seems more reasonable to extract this payment yearly rather than at the time of a transfer. Moreover, there might be some administrative economies since UIPT and the agricultural income tax are annual taxes, and since a cadastral survey is required in any case.

The present regime of taxing only transfers could be replaced with an annual tax on land in rural areas, perhaps imposed as a presumptive income tax on rural land. The umbrella for this new tax would be the agricultural income tax in the case of lands used for agricultural purposes, see the proposal below. For rural lands not used in farming, it would be a tax on annual rental value at highest use. Valuation would be carried out following the steps noted above. Urban land would continue to be taxed under the UIPT. No property would be assessed both a rural and an urban property tax.

How would this restructuring be done? First, the mutation fee, registration fee, and stamp duty on property transfers would be combined into a single land tax, levied on the basis of the market value of land. The rate would be set according to revenue considerations. Second, and in order to move to a unified annual tax, it will be necessary to prepare a cadastre showing the ownership and physical characteristics of every parcel. After this, a valuation table would be prepared for the province, and updated on a periodic basis. These comprehensive administrative improvements are within the reach of the provincial government. Necessarily, they would precede the structural reform.

The revenue yield from a unified annual tax on urban and rural property will depend on the nominal tax rate that is chosen. The elasticity will depend on the accuracy and timelines of revaluation and on whether there is indexation of property values. A unified, annual land tax with 'reasonable' rates and proper valuation could easily result in well more than a doubling of rural land tax revenues.

Not all would agree with eliminating the tax on property transfers. One reason is that a property transfer is an event that is easily identified by the taxman. Undervaluation may be common, but completely escaping the tax probably is not. There also are important transition issues. This structural reform would bring a major shift from the present tax regime, so a great many details would need to be worked out. Moreover, a political consensus would have to be reached among the many stakeholders before any legal drafting could go forward. However, the administrative reforms that would support this restructuring could be implemented in any case, since they also are necessary for improving the present regime.

Another reason why some would argue that the present regime cannot be abandoned is that property transfer taxes are a proxy for capital gains taxes on property investments. This is not a good justification for the present regime because the sales price of a property probably bears little relationship to the size of a capital gain. The capital gain depends on the real appreciation in value since purchase, whereas the property transfer tax depends solely on the gross selling price irrespective of any other factors including whether or not any gain had been made.

A capital gains tax on land could be introduced in addition to the annual land tax proposed above. In theory, the concept of a capital gains tax on land is straightforward. The tax liability would be taken on the difference between the buying and selling price of the property, indexed for inflation. The buying price (base) would be set according to historical records of purchase price. Owners could petition to have this base increased. The selling price would be verified by the valuation staff in the capital gains tax office. Note, however, that there would be a self-enforcing feature.[66] The nominal gain would be adjusted for inflation and for the cost of allowable improvements to the property, e.g. irrigation.

One disadvantage to this approach is that capital gains on real property would be taxed in a different way from capital gains in other sectors of the economy.[67] A major drawback is administration, especially establishing the basis for a capital gains tax, and developing a method for indexing for inflationary increases and adjusting for qualified investments in real property. As complicated as these administrative requirements seem, they are not any more daunting than the present requirement of establishing a true market values for every real estate transaction.

Such a tax system would have appeal. Revenues would not ebb and flow with land market activity, and the number of different taxes levied on rural land would be reduced. Once a capital gains tax became established, the unified administration would be more efficient at collecting revenues than is the case under the present regime. The incentives for under-declaration of property prices at the time of sale would be lessened. The result might be a better flow of information about land prices, which is necessary to develop a property market.

6. AGRICULTURAL INCOME TAX (AIT)

The Agricultural Income Tax (AIT) is collected by the Board of Revenue in both KPK and Punjab. Agricultural income is exempt from federal income tax, Federal Income Tax Ordinance (2001), and this has caused some controversy regarding both the ownership and the legality of the AIT. Malik claims that one of the main reasons for the controversy is that the tax is not specifically called out in the Constitution.[68] Both provinces, however, do impose the tax, although as a presumptive tax, and not directly as a tax on agricultural income. KPK started levying a land tax and agriculture income tax in July 2001, and is credited with some of the early policy development of the tax.

The Punjab Provincial Agricultural Income Tax Act of 1997 defines the base, rate, and collection of the tax. In theory, the base is income derived from agricultural land. In the 1997 Act, agricultural income is defined as rents received from property used for agricultural purposes, income derived from cultivation, or income derived from owner-occupied buildings on the property (including small businesses such as dairies). The Punjab Act provides for two alternative calculations of the tax. The first is based on land area, and the second is based on agricultural income. Officials in both provinces note that the land area method is the one actually used, and the income base is not used to apply the actual tax. In this regard, the agricultural income tax may be thought of as a presumptive income tax.

Revenue Performance

The AIT raises a relatively small amount of money for the Government of Punjab, see Tables 6 and 7.[69] Estimated collections in Punjab are Rs. 658 million in 2006 or 2.06 per cent of total own source revenue. This represents an average of Rs. 170.3 per farm, or an average of Rs. 1,669 per farm greater than 12.5 acres in size, based on data from the 2000 Census of Agriculture. Real per capita collections have fallen dramatically since 1999–2000, and by 2005–06, represented only 32 per cent of 1999–2000 collections.

The level of tax collections in KPK also is quite small, Rs. 70 million in 2005–06. This amounts to 1.53 per cent of total own source revenue. In NWFP, AIT collections are about on par with the level of collections from the professions tax. Based on data from the 2000 Agricultural Census, the average burden of the tax in KPK is Rs. 51.6 per farm or Rs. 241 per farm greater than 5 acres. Real per capita collections remained approximately constant in KPK between 1999 and 2006.

Valuation and Tax Base

In theory, all agricultural land is taxable under the agricultural income tax in both provinces. According to the law, the agriculture income tax can be assessed in two ways: one based on the value of crop output and the other a presumptive tax with flat rupee rates by farm size.

The tax laws provide detailed schedules for unirrigated land and irrigated land. In Punjab, irrigated land of less than 12.5 acres is exempt, and non-irrigated land with less than 25 acres is exempt.[70] In NWFP, there is no exemption level if the tax is calculated based on land area. However, in NWFP, the income-based schedule does include an exemption of Rs. 80,000 of agricultural income. The theory of the income-based exemption is that it provides for a minimum level of income from which families can take care of their basic needs. This Rs. 80,000 exemption is somewhat low by the current standard for the federal income tax—which is now Rs. 150,000. The same justification may be offered for the 12.5 acre exemption in Punjab, though some officials argue that 12.5 acres is too generous and represents more than a subsistence farm. However, using data from the Census of Agriculture on crop yield, the income earned from a 12.5 acre farm that specializes in growing wheat would be substantially less than Rs. 80,000 (depending on the treatment of rent and other inputs). In the case of most other crops reported by the Census, a 10 acre farm would generate income of Rs. 80,000 or more. Past efforts to reduce the minimum taxable farm size below 12.5 acres have failed in Punjab.

For the income method, the technical description of the valuation process is as follows. Theoretically, the land revenue staff establishes an average yield per acre for all crops cultivated in the district. The document is called *Jhar Paidawar*. Upon certification by the district collector, this becomes the operative formula for calculation of the tax base.[71] Similar estimates are prepared for each revenue estate, revenue estates are units within districts. In some cases, depending upon soil types and local factors, the revenue estate estimate may differ from the district estimates. In such cases the revenue estate formula is applicable for calculation of the tax base. Input prices and market prices for crops are based on surveys and analysis conducted as part of the Census of Agriculture. Many of the prices are fixed by government.

The focus of the tax is sown land area, but the valuation process is much less focused on crop inspections than on land tenure. In practice, the *patwari* performs a crop inspection every six months, called a *girdawari*, and uses these data to update the special register *khasra girdawari*. Owners and tenants have an interest in having their status reflected accurately, but in some cases, negotiation between the land owner and *patwari* can be substituted for the inspection. Land tenure, therefore, appears to be the central concern of the *patwari*'s work, and the crop valuation is relegated to a secondary concern. The lack of accurate, timely, and detailed data on ownership of land, crop yield, and input prices leads to a situation where there is little basis to establish the AIT liability based on income. That may be a principle reason that, according to our interviews, both KPK and Punjab use the farm area imputation to calculate AIT liability.

Tax Rates

In Punjab, the tax rate schedule for irrigated land (under the acreage tax base) is:

i. Less than 12.5 acres	exempt
ii. 12.5 to 25 acres	Rs. 150 per acre
iii. Over 25 acres	Rs. 250 per acre
iv. Orchards	Rs. 300 per acre

v. Non irrigated — one half the above

vi. Idle land — no tax

These tax rates have been constant since 1996, but the exemption level has changed over time. Prior to 1997, the tax was under the Land Revenue Act and the exemption was for 2.5 acres. When the Agricultural Income Tax was imposed in 1997, the exemption was set at 5 acres for a short time, before increasing to 12.5 acres. At some point after 2001, the BOR attempted to reduce the exemption back to 5 acres, but that proposal was met with significant political opposition.

The per acre tax rate structure is not a graduated marginal rate structure. Instead, all acreage of farm land in a rate class is taxed based on the same slab rate. For example, for a parcel of 50 irrigated acres, the tax rate is Rs. 250 on all 50 acres. Once the exemption threshold is reached, all land is taxable. This leads to large changes in the tax rate at each size boundary and may, in fact, encourage individuals to claim that they own smaller properties. Since the valuation system is not transparent, there may be a high probability of under reporting and not being detected.

In contrast, the income-based rate structure in Punjab, as shown below, is a progressive marginal rate structure.

Income bracket	**Rate**
Agricultural income is less than Rs. 80,000	Exempt
Agricultural income is less than Rs. 100,000	5%
Agricultural income is between Rs. 100,000 and 200,000	Rs. 5,000 plus 7.5% of the amount exceeding Rs. 100,000
Agricultural income is between Rs. 200,000 and 300,000	Rs. 12,500 plus 10% of the amount exceeding Rs. 200,000
Agricultural income is greater than Rs. 300,000	Rs. 22,500 plus 15% of the amount exceeding Rs. 300,000

In NWFP, the acreage-based structure does not allow for any exemption level, as seen in the schedule below:

Slab of land (1 irrigated acre = 2 unirrigated acres, excluding orchards)	Rate per acre
Less than 5 acres	Rs. 50
5 to 12.5 acres	Rs. 72
Greater than 12.5 acres	Rs. 100
Orchards (any acreage)	Rs. 300

Under the income valuation method, each owner of land is obliged to file a tax return, and is subject to the rates shown below. Theoretically, if the assessed tax under this method is less than that calculated by the acreage schedule, then the liability is to be determined by the second method, see schedule below. The BOR view, based on interviews in June 2007 in KPK, is that the *patwaris* and their supervising *tehsildars* do not have the capacity to assess AIT using the income method. Moreover, the land owners do not typically file an income tax return which reduces the ability to track their tax liability.

Income bracket	Rate
Agricultural income is less than Rs. 80,000	Exempt
Agricultural income is less than Rs. 100,000	5%
Agricultural income is between Rs. 100,000 and 200,000	Rs. 5,000 plus 7.5% of the amount exceeding Rs. 100,000
Agricultural income is between Rs. 200,000 and 300,000	Rs. 12500 plus 10% of the amount exceeding Rs. 200,000
Agricultural income is greater than Rs. 300,000	Rs. 22,500 plus 15% of the amount exceeding Rs. 300,000

In practice, the acreage method is used in both provinces.

General Administration

To the extent they exist, records on land holding and crops are maintained in duplicate; one copy is with the *patwari* and the second is kept at the district office. The *patwari* is in charge of all of the land records at the local level. The district collector is a registrar for the district as well as a tax collector, but in effect most of the record keeping functions are carried out by the *patwari*. The hierarchy of *Kanungo, tehsildar*, and District Collector perform supervisory roles.

Records. The AIT piggybacks off of the land transfer taxes in the sense, that the information recorded for each parcel is used for both taxes. The information includes the total land area, owner, tenant if any, type of land, and any encumbrances. Lands are inspected every six months and the status of occupancy and crops is updated, although the rigor of the crop inspection is suspect, as noted above, and by Khan.[72] There is discussion of computerizing this information in both provinces.

Titling. The system is four hundred years old. The *patwari* maintains records on title and ownership. Bank loans require copies of the records, and any mortgage is reflected in the records. The registers are often hand-carried by the *patwari*, tied in cloth, for field visits, following an age old tradition. The titling and tenure records are very important to the AIT, whether a land-based or income-based tax is levied, since that information is needed to identify the taxpayer. Clearly, there is need to modernize the mode of record keeping.

Collection. The *patwari* has responsibility for collections. He prepares the demand notice on the basis of his records and bi-annual crop inspections. A demand note is presented to the taxpayer by the *patwari*. Collection is in cash and deposits are made into the government account. The *patwari* receives no incentives for higher levels of collections.

Penalties. In all cases, there are penalties for non-payment, including seizure of land. The enforcement mechanism provided in the *Land Revenue Act 1967* is the basic legal mechanism which is invoked for collection of nearly all taxes and government dues in arrears. It is formally referred to as 'arrears of land revenue'. Once there is a declaration of the amount as 'arrears of land revenue' the provisions of Sections 80 to 89 of the Act follow eight stages for collection including:

a. Notice;
b. Attachment of personal property;
c. Detention of the defaulter, which may continue till the time; payment in full or in part has been received;
d. Attachment of real property and appointment of a receiver. The receiver then collects the arrears and deposits them with the government;
e. Attachment of real property; and
f. Seizure of property and sale for recovery of the arrears.

In Punjab the penalty for non-payment of tax is assessed at a rate of 5 per cent per year of the unpaid amount, not to exceed 50 per cent of the total unpaid amount. There is little evidence that land seizures or other of the penalties for non-compliance is carried out in either province.

Issues and Problems

The effective rate of agricultural income taxation is very low. The AIT provides very little support to the provincial budgets despite the fact, that agriculture is one of the largest sectors in the provincial economy.

The revenue potential of the agricultural income tax is much greater than its current yield. We have made estimates of this revenue gap using census data. The underlying data used in this analysis, baseline data of the area cultivated, by farm size, are presented in Table 10. An estimate of the potential AIT revenue, under the current land based tax structures for KPK and Punjab, is presented in Table 40. In Punjab, we estimate the potential revenue under current law to be Rs. 2.9 billion or more than 4 times the actual collections in 2000. For NWFP, we estimate potential collections under current law of Rs. 249 million, or 10 times the current level of collections. Malik got much the same result for KPK in an earlier study.[73] While these estimates are rough, they do suggest that the orders of magnitude of evasion, compliance, and administrative problems are very large.

The major reasons for these revenue shortfalls are because the tax base has been significantly eroded by exemptions in the case of Punjab, and because the tax is not well administered in either province. The level of exemption in Punjab, 12.5 acres, significantly narrows the tax base. Based on data from the Agriculture Census 2000 (ACO, 2000), approximately 85 per cent of all properties are outside the tax base. While some provincial level officials in Punjab took the position that 12.5 acres of irrigated land was well above subsistence and there was room for taxation, others said this was not the case. They also pointed out the political difficulties inherent with increasing this tax.

We simulate the potential revenue associated with reducing the exemption in Punjab from 12.5 acres to 5 acres. This would yield potential AIT revenue of Rs. 4 billion, see Table 41, but would tax some farmers with incomes less than Rs. 80,000.[74] If the relative compliance rate and administration costs were similar for large and small farms before and after this change, this would increase actual AIT revenue in 2005–06 from an estimated Rs. 658 million to nearly Rs. 910 million in Punjab.

Another problem with the present structure is that it makes no allowance for the fact that some crops are more lucrative than others. For example, sugar cane yields Rs. 15,000 net per acre, while many other crops net Rs. 8,000–9,000 per acre.[75] This results in unfairness in the tax system.

The system of administration, while well documented in law, is not enforced. Observers point out that neither the revenue officials nor the taxpayers are adequately familiar with the legal requirements and details. The required information and records are not maintained so that holdings and crop values are not updated. While there is information available to estimate crop value, gross income is typically determined on an ad hoc basis.

Is the Agricultural Sector Undertaxed?

Some would argue that there is a broader question of whether the agricultural sector is 'undertaxed' in Pakistan. This concern might be put forward in its most simple form: while agriculture's share of national income is 23 per cent, 20.6 per cent in 2006–07, the sector 'pays' a very small percentage of tax revenue. There has been a debate about whether these statistics are suggestive of an 'undertaxation'. Chaudhry refutes the underpayment argument and points out that there are implicit taxes on agriculture such as those associated with price controls for many farm products.[76] These controls keep agricultural prices, and revenues, artificially low relative to the world price. Khan points out, correctly, that the incidence of all taxes, implicit or explicit, is on individuals and the focus should be the incidence of the tax on consumers, labour or capital and not on sectors.[77] By this argument, the concept of the 'tax burden of the agricultural sector' does not have a great deal of meaning.

Clearly, there is merit to the argument that implicit taxes have resulted in higher effective tax rates on agriculture relative to statutory rates, and relative to effective tax rates on some other sectors in the developing world. These 'taxes' come via macroeconomic policies as well as explicit taxes on the agricultural sector. Many countries protect their industrial sector—artificially raising prices of certain agricultural inputs, while controlling output prices for the agricultural sector, often below world market prices. In addition, in many countries, protectionism has led to increases in the exchange rate which in turn reduced the competitiveness, and net returns, from agricultural exports. Chaudhry and Kayani calculated the implicit taxes on agriculture in Pakistan between 1970 and 1990 and found effective rates as high as 75 per cent, with wide variation among crops and years.[78] Rajaraman discusses the impact of the same set of macroeconomic factors and taxes on the agricultural sector in India.[79]

The World Bank argues that the net taxation of agriculture has fallen dramatically in most countries during the last twenty years.[80] The estimates take account of both implicit and explicit taxes. Can we assume that Pakistan has followed this same pattern? We have not analysed all of the explicit and implicit taxes on agriculture in Pakistan. However, the absence of export taxes and declining customs duties suggest that the effective tax rate on agriculture in Pakistan has followed the worldwide trend of decline. A full analysis of macroeconomic policies and federal and local tax policies toward agriculture would be needed to make a good estimate of the total tax burden on agriculture. Anderson finds that in Pakistan, the effective level of taxation of agriculture declined from approximately 18 per cent to less than 5 per cent (see Box 5).[81] Implicit taxes on agriculture still exist in Pakistan, but there is evidence that they are much smaller now than in previous years.

We might shift the question from whether we have the 'right' level of burden on the agricultural sector, to whether there is a case for increasing the level of taxes raised from agricultural income. From a horizontal equity perspective, there seems to be some justification for a higher level of agricultural income tax. Agricultural income is exempt from income tax, so non-farming households at any given income level face a higher tax burden on their labour income than do agricultural households. While there are certainly inequities in other parts of the tax system, this one can be particularly egregious because the federal income tax generates a substantial portion of revenue for the central government and because there are large numbers of individuals employed in the agricultural sector. In 2005–06, 44.4 per cent of employed people in Punjab were engaged in 'agriculture, forestry, hunting, and fishing' and 44.3 per cent in KPK were in this sector.[82] While these figures include those in forestry, hunting, and fishing, these are upper-bound estimates of the relative size of the agriculture labour force. Additionally, these figures do not account for the level of relative productivity among the sectors.

Box 5
Changes in Protection and Taxation of Agriculture Sector, 1980–1984 to 2000–2004

Anderson reports that in three groupings of countries, agriculture-based, transforming, and urbanized, macro and public finance policies reduced the effective rate of taxation on agriculture in 24 out of 28 countries.[83] In his analysis, higher explicit and implicit taxes yield a negative 'nominal rate of assistance', where subsidies or protection of the sector yields a positive nominal rate of assistance. Most urbanized countries now provide a positive rate of assistance while the rate of assistance in most transforming countries is negative:

Transforming Country	Estimate of nominal rate of assistance 1980–84	Estimate of nominal rate of assistance 2000–04
Indonesia	+10 to 15	+35
India	+0 to 5	+15
Thailand	- 5 to -1	+5 to + 10
Malaysia	-10 to -5	+3 to +5
China	-50	+1
Pakistan	-18 to -15	-5 to -2
Sri Lanka	-10 to -8	-7 to -3
Egypt	-20 to -15	-15 to -10
Senegal	-30	-18 to -15
Zimbabwe	-45	-70 or less

Source: Estimates based on information presented in World Bank, 2007 and Anderson (forthcoming as reported in World Bank, 2007).

Secondly, because agriculture is such a large part of Pakistan's economy, not taxing agricultural income means that effective tax rates on other sectors of the economy must be higher, or public service levels must be lower. This is bound to decrease the economic efficiency of the tax system as taxpayers in these other sectors seek ways to avoid or evade those taxes. Third, the agriculture income tax may be justified, at least partially, on the principle that government infrastructure provides benefits to the agricultural sector. The agricultural sector also benefits from low interest loans and public expenditures on research and development. Though we have not done a cost-benefit analysis, it might be argued that this flow of benefits constitutes a justification for increasing the agricultural income tax.

All of this said, there is still the question of price controls, both for inputs as well as final outputs of the agricultural sector. This complicates the discussion of raising the revenue take from the agricultural income tax. Raising taxes without releasing these price controls could effectively reduce the level of taxpayer profits. There would be no possibility to shift the tax increase to consumers, as there might be if demand for the output was relatively inelastic. Farmers could reduce output, or quality, as a result of the tax increase. Federal government reactions to a provincial tax increase, eliminating output price controls or increasing subsidies for inputs, are impossible to forecast. In the short run, it is very possible that the incidence of any tax increase on the agricultural sector would fall on the farmers and on farm owners.

Reform Options[84]

In both provinces, the BOR officials discussed the need for the agricultural income tax to become a larger contributor to the budget. Officials also discussed the need, theoretically at least, for the tax to become an income-based levy. These reform ideas are not new, and they are controversial. A number of previous studies have analysed the agricultural income tax in Pakistan. Chaudhry notes that between 1959 and 1993, nine commissions were formed to study the AIT and only two recommended an income based agricultural tax.[85] Khan notes that the study of the 1960s and 1970's recommended against an AIT because of other implicit and explicit taxes that existed during that time.[86] Other studies have pointed out that although the majority of farmers are subsistence farmers, some make large incomes.[87, 88] Malik concludes his study of KPK with the view that there is substantially greater revenue potential in the tax.[89]

Structural and administrative changes. There are a number of options for reforming the agricultural income tax. Administrative reforms should come first. The major reform risk is that no option will yield substantial increases in revenue if the administration of the system is not enhanced. The Punjab Resource Management Programme outlines changes in administration that might increase compliance with whatever AIT system is considered.[90] Some of these changes are quite dramatic relative to the current practice and include additional checks and balances in the system. The Punjab Report discusses pros and cons of these alternatives. In addition, the report presents a major restructuring of the BOR and Excise Tax Departments under one Provincial Revenue Authority. These administration reform options include the following:

- Creating a withholding system for the AIT, where tax is withheld on the purchase of agricultural inputs, with an exemption limit for small farmers;[91]
- Creating a withholding system on the sale of cash crop outputs;
- Expansion of the self assessment scheme;
- Expand the information kept in the base records (*Khasra Girdawari*) to include the Produce Index Unit System, estimates of costs of inputs and gross receipts by crops, into the records.

If these types of administrative reforms are brought on line, some structural changes could go forward. One major change is that the provinces could retain the basic approach of taxing the farm size, but this could be augmented with a presumptive assessment based on crop type and expected net income. Eventually, self-assessment must be considered as part of this process. But, until the administration is upgraded, we do not think that self assessment would reduce the inequities in the system or increase tax revenues.

A reform programme for the agricultural income tax might begin by considering two types of options, land-based presumptive options or income based presumptive options.[92]

Land-based Presumptive Reforms:

- First, reduce the exemption level in Punjab. The exemption of 85 per cent of all land would seem an unreasonable level. An alternative would be to have no exemption and to charge a nominal (flat) amount for small farms. This would raise administrative and compliance costs but would expand the tax base to cover the entire sector. As shown above, this would increase revenue in Punjab by 38 per cent.
- Second, the tax rates could be increased. The new rates could be set according to revenue targets, or to redress sectoral imbalances, or to gain parity with taxpayers in other sectors of the provincial economy or among those with similar levels of income.
- Third, a more progressive rate schedule could be developed.

These options have some advantage over the income-based option because of their simplicity. However, they may perpetuate a presumptive system and prevent the AIT from growing into a 'true' income-based tax in the long-run.

Income-based Presumptive Reforms:

- Define a presumptive net income amount by farm, based on farm size and crop type. The rates could be flat or variable. A subsistence level of income could be exempt from tax, similar to the personal income tax exemption of Rs. 100,000.[93] This option has the benefit of keeping the AIT a direct tax on income.

We estimate the impact of such reform options on total revenue, assuming that full collection takes place. In other words, these should be considered potential revenues from these reform alternatives. In most cases, our base data are from the 2000 Agricultural Census, Pakistan. We do not attempt to update the size distribution of farms from the 2000 Census.

We simulate a variety of land-based rate structures. Different crops yield very different levels of net income for farmers. So, it might be considered more equitable to impose the land-based taxes at a differential rate based on crop. The overall progressivity of the tax could also be enhanced by adjusting the slab rates, by crop and acreage or simply by acreage.

The Agriculture and Policy Institute Centre (2004, 2007)[94] estimates the profit/loss per acre for major crops in Pakistan. Based on their data for Punjab for 2002–03, sugarcane is the most lucrative crop, yielding Rs. 7,503 per acre including cost of land rent, while wheat profitability is actually negative, 542 per acre, if land rent is included. The estimates for Sindh are larger, and Malik (2004) uses the values from Sindh as proxies for KPK in estimating potential income from agriculture. After sugarcane, rice, and cotton are the most lucrative crops. More scenarios could be considered, for example, a progressive rate structure depending on crop type or more distinction among crops[95] but adding too much complication to the system could result in a further deterioration of tax compliance. We consider three specific reform programmes.

Two land-based reform scenarios that might be considered are as follows:

Option a. *Progressive rate structure, independent of crop*: 7.5 acre exemption for irrigated or unirrigated land; 7.5 to 25 acres taxed at Rs. 100 per acre, 25 to 50 acres at Rs. 150 per acre, 50 to 150 acres at Rs. 200 per acre, and Rs. 300 per acre for farms greater than 150 acres.[96] Unirrigated land would be taxed at half the rate of irrigated land and orchards would be taxed at Rs. 300 per acre. Our simulations by farm size give a result of an 11 per cent revenue increase in KPK and a 21 per cent increase in Punjab.

Option b. *Flat rate structure by crop type*: 7.5 acre exemption for all farms, except orchards; wheat taxed at Rs. 100 per acre, cotton taxed at Rs. 200 per acre, rice taxed at Rs. 300 per acre, and sugarcane taxed at Rs. 350 per acre. These amounts were chosen based on the relative level of profitability of these crops. Unirrigated land taxed at Rs. 150 per acre regardless of the crop.[97] Orchards would be taxed at Rs. 300 per acre. Our simulations show that revenues would increase by 27 per cent in KPK and 37 per cent in Punjab.

An income-based reform scenario might be considered:

Option c. *Tax presumptive net income based on crop yield and profitability, with exemption of Rs. 100,000*

> *and progressive rates from 5 to 15 per cent.* Our simulations show that revenues would increase by 20 per cent in KPK and 10 per cent in Punjab.

Using data from the Agricultural Census, Board of Revenue, and Agriculture and Crop Reporting Centre, we can estimate the revenue impact of these proposals. Relative to current law, Option (a) increases revenue by 11 per cent in KPK and by 21 per cent in Punjab. The resulting distribution of tax burden is more progressive than the present system under this reform scenario. Option b imposes a tax structure based on farm size, but adjusted for crop type. Adjusting the land-based rates by type of crop is admittedly a more complicated way to go. However, this type of reform brings the AIT closer to a tax on potential income than the tax structures based on land alone. We estimate this approach considering four crop types: wheat, cotton, rice, and sugar cane. For these purposes, we collapse other grains and fruits and vegetables into the wheat category. These categories can easily be changed. The revenue impact for KPK is an increase in AIT of 27 per cent and the increase in Punjab is 37 per cent under this structure.

Finally, we estimate the revenue potential of a tax based on potential income (Option c), where income is estimated based on the average profit/loss including land rent per crop, per acre. To simplify the analysis, similar to that done by Malik (2004), we estimate the potential revenue assuming an average net profit per acre of Rs. 4,000, lower bound of all crops, and Rs. 8,000 per acre, an upper bound estimate of the average crop yield. With a threshold of Rs. 100,000 for tax purposes, on average, only farms of 25 acres or more would be taxable. The revenue analysis suggests that this structure could yield Rs. 280 million in KPK, a 20 per cent increase, and approximately 2.9 billion in Punjab, a 10 per cent increase, assuming that such a tax could be administered. The smaller increase in Punjab is due to the relatively large number of farmers that would be exempted due to the Rs. 100,000 threshold.

7. CONCLUSIONS AND IMPLEMENTATION

The taxes on land form the main source of revenue for the provinces in Pakistan. The reforms may adopt one of the two approaches. The incremental approach will comprise of reforming the individual taxes mainly by broadening the bases through progressively abolishing the exemptions. In case of urban immovable property tax, the first step will be to do away with the 5 marla exemption. This should considerably broaden the base and increase revenue. At the same time, it will improve horizontal equity and enhance tax morale. Progressively, the rate structure should be reformulated to allow tax collector arrive at appropriate property valuation. Taxes on land and property transfers are major sources of revenue for the provinces. Despite their current position in the tax structure, there is wide spread undervaluation resulting in low revenues. Administrative reforms and revision in tax rates will help increase revenue. The encroachment on the revenue base by the federal government should, also, be removed. In the longer run, as argued in the chapter, a comprehensive reform may aim to fold the transfer on property taxes into the property taxes. This will simplify taxes on immovable property. Agriculture income tax is not yielding as much revenue as it should. This is due to the tax structure which renders it as a land tax rather than an income tax. Tax administration is also weak and contributes to failure of this tax to yield higher revenues.

Table 9
Property Transfer Taxes on Real Estate: Selected Countries

Country	Tax Rate
Pakistan	
Punjab	9%
NWFP	10.5%
Jamaica	13%
Portugal	Graduated rate ranging from 2% to 6.5%. Rate varies by value and land use.
Germany	3.5%
Slovakia	1% to 6%, depending on value
Czech Republic	3%
Netherlands	6%
Pakistan	5%
Bhutan	5%
Taiwan	7.5%
Mauritius	Between 5% and 10%
Swaziland	Between 3% and 4%, depending on value
Costa Rica	1.5%
El Salvador	Up to 3% depending on value
Kenya	4%

Sources:

Portugal: *Tax Notes International*, 21 April 2003, 227.
Germany: *Tax Notes International*, 14 January 2002, 102.
Slovakia: *Tax Notes International*, 8 March 2004, 915.
Czech Republic: *Tax Notes International*, 5 January 2004, 26.
Netherlands: *Tax Notes International*, 16 June 2003, 1093.
Bhutan: *Taxes and Investment in Asia and the Pacific*, Supplement No. 104, 1993, International Bureau of Fiscal Documentation.
Taiwan: *Taxes and Investment in Asia and the Pacific*, Supplement No. 165, 1998, International Bureau of Fiscal Documentation.
Mauritius: *African Tax Systems*, Supplement No. 117, 2000, International Bureau of Fiscal Documentation.
Swaziland: *African Tax Systems*, Supplement No. 105, 1997, International Bureau of Fiscal Documentation.
Costa Rica: *Latin American Taxation Database*, Supplement No. 122, 2000, International Bureau of Fiscal Documentation.
El Salvador: *Latin American Taxation Database*, Supplement No. 113, 1998, International Bureau of Fiscal Documentation.
Kenya: *'Land Value Taxation: A Case Study Approach,'* McCluskey and Franzsen, 2001.
Pakistan: Data supplied by Provincial Government Officials. Rates are inclusive of the Central Government Capital Value Tax and the Local Government Tax.

Table 10
Distribution of Cultivated Area by Farm Size (2000)

	Cultivated area	Irrigated area	Of which orchards	Unirrigated area
NWFP				
Farm Size (acres)				
All Farms	4,096,033	2,256,518	68,202	1,839,515
Govt farms	2,414	2,271	203	143
Private Farms	4,093,619	2,254,247	67,999	1,839,372
under 1	139,271	73,320	8,503	65,951
1 to under 2.5	634,503	308,591	20,080	325,912
2.5 to under 5	741,897	383,937	9,134	357,960
5 to under 7.5	591,398	316,867	4,731	274,531
7.5 to under 12.5	643,086	359,488	6,514	283,598
12.5 to under 25	491,899	258,750	4,432	233,149
25 to under 50	391,901	203,571	6,825	188,330
50 to under 100	215,082	152,105	2,637	62,977
100 to under 150	95,600	78,118	2,871	17,482
150 and above	148,980	119,485	2,273	29,495

	Cultivated area	Irrigated area	Of which orchards	Unirrigated area
Punjab				
Farm Size (acres)				
All Farms	25,485,032	21,500,989	427,705	3,984,048
Govt farms	45,326	36,674	1,179	8,653
Private Farms	25,439,706	21,464,315	426,526	3,975,395
Under 1	160,592	117,906	1,434	42,687
1 to under 2.5	1,408,581	1,157,827	13,147	250,757
2.5 to under 5	2,778,289	2,390,055	29,913	388,244
5 to under 7.5	3,315,357	2,876,676	42,497	438,682
7.5 to under 12.5	4,836,591	4,214,124	66,261	622,457
12.5 to under 25	5,489,884	4,735,774	94,293	754,118
25 to under 50	4,062,726	3,275,912	79,248	786,818
50 to under 100	1,954,161	3,134,852	52,629	453,268
100 to under 150	520,610	421,982	15,124	98,629
150 and above	912,909	773,174	31,988	139,737

Source: ACO (2000).

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NOTES

1. Calculated from Table 4.2, Statistical Appendix in Government of Pakistan, 2007.
2. Government of Pakistan, 2007.
3. Bahl, Heredia-Ortiz, Martinez-Vazquez and Rider, 2005.
4. Since the abolition of 'One Unit' governance in 1970, the provinces have adopted Punjab tax laws and followed the tax policy of Punjab. The Inter-Provincial Coordination Committee also seeks tax harmonization.
5. World Bank, 2000.
6. Bird and Acosta, 2005.
7. There is enough difference between the practice in Punjab and NWFP that we have chosen to treat them in different sections in this report. Still, much of what we say about the practice for Punjab also applies to NWFP.
8. Government of Punjab, 2007a.
9. Ghaus-Pasha et. al. (1998), 11.
10. Cyan, 2007.
11. A new valuation method was introduced in 2001–02. It met legal challenges with the result that collections were low in 2001–02. Collections surged in 2002–03 as arrears were collected, but were lower again in 2003–04 as arrears petered out.
12. Bahl and Martinez-Vazquez, forthcoming.
13. There were no discretionary rates or base changes during this period.
14. The revenue flow is erratic because of late payments and collections of arrears.
15. See Bahl, Martinez-Vazquez, and Youngman (forthcoming) and, Bird and Slack (2004).
16. Prior to the Property Tax Act of 1958 there was a house tax, and a separate property tax, each levied at 10% of rental value. Later, through an amendment to the Act of 1958, these two taxes were unified into a tax on rental value at 20%.
17. This is the approach taken in most developing and transition countries where reliable data on market rents or property sales values are not available.
18. The system is different in Pakistan vs. most other countries using the area method in that it defines an 'Area Unit' as the sum of land area in square yards and covered area in square feet.
19. The Urban Unit, 2006.

20. The Urban Unit, 2006, 18.
21. For a discussion of the record keeping system, see The Urban Unit (2007).
22. In Argentina, about 20–25% of taxpayers fail to pay their property taxes. In Tamil Nadu, a relatively well-managed Indian state, arrears were equivalent to about 50% of demand. In Poland, arrears were equivalent to less than 10% of taxes billed. (Bird and Slack, 2004; and Bahl and Martinez-Vazquez, forthcoming.)
23. Eckert (forthcoming) argues that computer assisted mass appraisal can be applied in transition and developing countries, and cites evidence of its successful use in both Kosovo and South Africa. He also argues that the use of computerized mass appraisal can accelerate the development of real estate markets.
24. Government of Punjab, 2007a.
25. The assessment ratio is assessed rental value expressed as a per cent of true market rental value.
26. Bahl, Martinez-Vazquez and Youngman, forthcoming; and Bird and Slack, 2004.
27. State Bank of Pakistan 2007; Table 8.1, 208.
28. It takes about one year to develop a new valuation table.
29. Government of Punjab, 2007a.
30. The Urban Unit 2006, 2007.
31. An interesting idea that has become part of the discussion is that the cost of property tax exemptions will be estimated, and will act as an offset to the inflow of intergovernmental transfers.
32. 'Tax shock' refers to taxpayer reaction to a large one time increase in taxes, irrespective of the amounts involved.
33. See also The Urban Unit (2006), 18.
34. For a discussion of the methods used to make this estimate, see Appendix B.
35. This estimate is made assuming the tax rate on a 5 marla premise is equal to one-half the average rate on a rented residential unit.
36. This is really an illustration rather than an estimate because we have no basis for estimating the share of industrial properties in the base. The ET department, however, does have the necessary data to make a more accurate estimate of the revenue to be gained from such a reform.
37. Bahl, Martinez-Vazquez and Youngman, forthcoming; and Bird and Slack, 2004.

38. We estimate the provincial government payment in lieu of property tax (GPT) as

    $GPT = 0.75rg\ (ARV)$

    where

    r = statutory rate, which is assumed to be 22 per cent.

    g = provincial government annual ratable value as a per cent of the present level of ratable value, as estimated above. We estimate g = 6 per cent, which is the ratio of provincial government expenditures to provincial GDP.

    ARV = annual ratable value estimated above at 2006–07 levels as Rs. 3.7 billion.
39. The expenditure elasticity was calculated by assuming that local government expenditures remain constant at 27% of the total provincial expenditure (local government transfers in 2005–06 were 27% of the total provincial expenditure). The own source revenue of the local governments also contributes to their expenditure, so this estimate represents a lower bound for the elasticity.
40. The percentage estimated here is biased downward because of the unusually low level of collections in 2005–06.
41. We are not able to separate collections of arrears from collections of current year liability.
42. Khan, 2004.
43. We have no independent data on actual property value increases, and no sales-assessment ratio study is carried out by the government.
44. Khan, 2004.
45. Khan, 2004.
46. Presumably, the implicit value is based on market rental value.
47. The calculation is based on the assumption that residential and commercial properties fall in the four location classes according to these percentages: A = 0.5, B = 0.25, C = 0.50 and D = 0.20. To take into account the effects of base broadening we add the number of 5 marla units to the D category of residential, industrial property units to the B category of commercial, and vacant lots to C category of residential.
48. Khan, 2004.
49. Government of Punjab, 2007c.
50. The UIPT is collected by the Excise Tax Department.
51. Another way to look at the revenue burden from land taxes is in terms of the tax per hectare of cultivated land. In the table below we show that

Punjab taxes a hectare of cultivated land 2.6 times more heavily than does NWFP.

52. For agricultural land, a person can choose to have the transaction recorded as a 'mutation only' or a 'registration' followed by a 'mutation'.
53. The data reported in Tables 34–36 differ from that reported in Table 37. This is because the data sources differ and because of classification differences.
54. Aggregate data on local government finances are not available for either province.
55. Government of Punjab, 2007c.
56. Government of Punjab, 2007c.
57. Government of Punjab, 2007c.
58. The local tax on transfer of property is collected by the TMA through private contractors. The TMAs award annual contracts based on a competitive bidding process. The reservation price that the TMA announces is generally a notional incremental increase in the previous year's price. They do not conduct valuation surveys or market research to compute a more realistic reservation price. The in-house expertise of TMAs is weak. They do not have staff expertise in property markets. The contractors assign their collection personnel to sit at the registrar's office. The registrar, following government instructions, will insist on seeing a receipt for payment of property transfer tax before he attests the registration deeds. The valuation of the property is however carried out by the registrar. He does this by reviewing the reported value of transaction. The contractor's representative at the point of collection does not have clear incentives to collect the full amount of revenue due to the municipality. If the parties offer to settle for a sufficiently low valuation resulting in a lower liability, they can still save money after paying the contractor. The contractor's representative collects the revenues and deposits the amount according to the payment schedule, not necessarily according to the payment received. The contract calls for a lump sum amount payable to the TMA.
59. Government of Punjab, 2007c.
60. Land revenue (largely mutation fee), registration fee and stamp duty have declined as a percentage of GDP in both Punjab and NWFP from 2004–05 to 2005–06.
61. Government of Punjab 2007e, 89.
62. Government of Punjab, 2007c.

63. This section draws heavily and directly from Bahl (2004).
64. Among the possibilities for an index is the rate of growth in agricultural sector GDP.
65. In 2005–06, revenue collections in Punjab were Rs. 11.4 billion and the property transfer rate was 20%, implying a total value of exchanged property of Rs. 378,786 billion. If property exchanges hands on average, every fifth year, the implied total value of land is Rs. 1,893,933 billion. If the assessment ratio were 50 per cent, the estimated total land value would be Rs. 3,787,865 billion, which is 86% of regional GDP.
66. Buyers would have a disincentive to under-declare the purchase price because their basis for a future tax on capital gains would be too low.
67. Thirsk (forthcoming).
68. Malik, 2004.
69. Government of Punjab, 2007b.
70. In all cases, the land area is sown land area.
71. There are typically two growing seasons and if a farmer grows in one season but not in another, he is supposed to be taxed as having grown all year according to the explanation given by the Board of Revenue. Based on the description of the valuation method, it is not at all clear that this provision can be enforced.
72. Kahn, 2004.
73. Malik, 2004.
74. Including those farmers growing low yield crops such as wheat.
75. It is our understanding that the sugarcane crop yields cover one year while the other crop yields cover less than a full year. See Agriculture Policy C, 2007.
76. Chaudry, 1999.
77. Khan, 1999.
78. Chaudhry and Kayani, 1991.
79. Rajaraman, 2000.
80. The World Bank, 2007.
81. Forthcoming, reported in the World Bank, 2007.
82. Pakistan Statistical Yearbook, 2007.
83. Forthcoming, reported in World Bank 2007.
84. Ahmed and Stern (1991) also discuss whether agriculture *should* be taxed differentially relative to other sectors of the economy.
85. Chaudhry, 1999.
86. Khan, 1999.

87. Coopers and Lybrand, 1989, NTRC, 1986.
88. The agricultural income tax in India is also a state levy, but it is used in only six states (Rajaraman, 2000). Sundharam and Andley (2003) discuss the need for an agricultural income tax levied on presumptive income in India. The Indian Taxation Inquiry Commission recommended an income-based agricultural tax that would eventually be merged into the general income tax system. These recommendations have not been accepted in India (Sundharam and Andley, 2003).
89. Malik, 2004.
90. Government of Punjab, 2007c.
91. An observer points out that this may be most useful in the case of government procurements and that universal application could lead to additional leakages in the system.
92. Another alternative is to tax rental income. It has been reported in various interviews that many of the farms are actually worked by sharecroppers, individuals and families who rent the land. Rental values should reflect the potential value of agricultural output of the land, so taxing rents would be similar to a presumptive income tax. Non-rented plots could be taxed presumptively by using established rental values. However, there is little evidence that information on rental values and tenants is readily available. Since there is a mechanism to measure crop output and values, as flawed as it might be, it may be administratively easier to estimate potential value of output. Also, the tax might be integrated with the general income tax. However, given the constitutional issue related to the taxation of agricultural income, it might be difficult to treat agricultural income like other forms of income for tax purposes.
93. The actual level of income tax exemption is currently Rs. 150,000 as of 2007. This represents a steep increase in the threshold which may not be sustainable. For purposes of the reform options analysed here, we use the previous income tax threshold of Rs. 100,000 as a benchmark, Thrisk (forthcoming).
94. Formerly the Agriculture Price Commission.
95. Gurmani et al. (2006) document differences in profitability among grains, for example.
96. While the exemption level chosen is largely illustrative, it corresponds to an income exemption of Rs. 80,000 for crops yielding Rs. 10,000 or more per acre. This would be on the high end of productivity for typical crops according to the Agriculture and Policy Institute. The 7.5 acre cut-off

is used since it corresponds to readily available data on crop size that is produced by the Census of Agriculture.

97. We do not have detail on the profitability of farms by crop type for unirrigated plots so those estimates are not included in this analysis.