

XXI. Tax on Lands and Buildings and Related Taxes

23. *Having regard to the provisions of article 243X under which the Legislature of a State may, by law, authorize a Municipality to levy, collect and appropriate, inter alia, such taxes in accordance with such procedure and subject to such limits, the question for consideration is as to what provisions may be made in the law relating to “tax on lands and buildings and related taxes other than property tax”.*

Deficiencies of Rent-based Valuation System

(1) The issues which any State Government needs to consider regarding the *rent-based valuation system* now in vogue in most of the States relate to the following :

(a) *its tax base* with its limitations due to rent control laws resulting in low valuations even in high priced inner city areas and the consequent declining trends in the per capita contributions as the densities of such areas are ever on the increase while the per capita expenditures in such areas are also on the increase

(b) *its administration* which is influenced by : absence of open markets in rental and sale transactions, the non-availability of professionally trained valuers, the subjective assessments in a corruption-prone administrative environment, the scope for excessive use of discretionary powers for individual assessments, the higher social costs due to litigation, and the issues related to the “unit of assessment”

(c) *the revenue losses* due to voids and built-in-defects of the system such as absence of land records on ownership, absence of tax mapping and defective rate structures, and, consequently, the inadequacy of the revenues mobilized even to meet the maintenance needs, and

(d) *the complete absence of interface with land policies* resulting in disincentives for new construction, preservation of decayed housing stock and non-conforming uses and absence of appropriate “vacant land” taxes resulting in speculative tendencies.

Policy Objectives for New System

(2) The *policy objectives* for selection of “a new system of property tax” need to be guided by the following considerations :

- (a) the need to satisfy constitutional, legal, political, administrative and socio-economic aspects, *all considered together*, with emphasis relevant to each
- (b) the need to provide scope for policy level determination of the tax burden on non-residential sector versus the residential sector
- (c) the need to ensure that the existing inequities in tax burdens on similarly placed or similarly used premises are removed
- (d) the need to remove the element of subjectivity in assessments with due regard to the corruption-prone administrative environment
- (e) the need to limit the use of discretionary powers in respect of “classes of assesseees” as against “individual assesseees”
- (f) the need to ensure the cost-effectiveness of the proposed system, and
- (g) the need to ensure interface between taxation policies, land policies and policies for town planning, economic development and urban development.

Grounds for Challenges in Courts

- (3) The *grounds for challenges* of any system of property tax in the Courts are :
- (a) rational basis of classification of assessed premises
 - (b) proper procedure for determination of annual values and imposition of the tax
 - (c) reasonableness of the tax levied, and
 - (d) protection against excessive delegation to the subordinate authority.

Annex 6 provides the case law evidence on the above based on an in-depth TRF study of 39 court cases.

New Area-Linked System

(4) Of late, a number of initiatives have been undertaken for introduction of *new area-linked systems* for the levy of property tax. Notable among these are : the Patna Model (see *Annex 7*), the Gujarat Model (see *Annex 8*), the Madhya Pradesh Model (see *Annex 9*), the Tamil Nadu Model (see *Annex 10*), the Karnataka Model (see *Annex 11*) and the TRF Model (see *Annex 12*).

The legislative schemes of these Models have also been provided in the relevant *Annexes* to enable any State Government to make a choice among the various other Models.

A Critique on the New Systems

(5) As stated earlier, several initiatives based on the general principles of the area-linked system for property tax reforms have been proposed and some of those have either been challenged in the courts and struck down, or, based on informed legal opinions, are susceptible to challenges.

(a) in the Tamil Nadu and Gujarat models, as enacted, another aberration appears to be there from the “principles of equity” and the “quantum of resources” which may be mobilized. Both these laws straight away fix the “unit area tax rates” rather than the “unit area values”. If the unit area values are fixed based on the locational, structural and age characteristics and, thereafter, taxes are levied on a progressive basis, the rich and the poor in the same neighbourhood would not be treated alike.

(b) in addition, in the Tamil Nadu Urban Local Bodies Act, 1998, for the purpose of “classification”, the location of buildings is identified under three categories, namely, along :-

- arterial roads, bus route roads leading to arterial roads and main roads,
- bus route roads other than those specified in (a), and
- roads and streets in primarily residential colonies.

It can be easily concluded that the selection of roads with bus routes may vary from time to time and is not guided by any statutorily defined principles.

In the Gujarat Act, the classification is made only in terms of “residential buildings”, and “other than residential buildings”. However, no other locational characteristics are used as is done in the Tamil Nadu Act.

In the model proposed by TRF, the location of lands and buildings is specified on the basis of their location -

- (i) in “wards”, which are “statutorily defined” , and
- (ii) “along street categories”, namely, arterial, sub-arterial, collector and local roads, and pedestrian pathways, which are also “statutorily defined”.

As such the basis of classification leaves very little discretion, even for the State Government, which is highly desirable.

(c) In the Karnataka model, the capital value system has been introduced for the purposes of assessment of property tax. This system though theoretically justifiable, may pose political issues, particularly, for assessment of properties

in the high priced inner city areas where the present valuation are dismally low.

(d) while evaluating the TRF model on the basis of the criteria listed under the paragraphs on “Grounds for Challenges in the Courts” and the “political criteria” attendant on ushering in any new system which would be applicable, both, to the “existing assessees” as well as to the “new entrants” in the housing and real estate markets, it may be noted that :

- rather than the State Government, a statutorily defined committee would notify the annual values of lands and buildings, invite objections and after their disposal, fix the annual values. Legally, this ensures that the *procedure* is fair.

The procedure involving declaration of intention to classify the lands and buildings in each ward into a number of groups and specification of the annual values therefor as also the opportunity for filing objections and hearing thereof makes the assessment procedures free from undesirable interventions, political or those motivated by use of corrupt practices,

- the *basis of classification* as proposed above in terms of the “locational” and “structural” characteristics is of a *statutory* nature,
- the constitution of a “quasi-judicial Municipal Valuation Committee” for classification of lands and buildings into various groups and for fixation of unit area values for such groups and the scope of appeals before a “Municipal Assessment Tribunal” provide the best possible framework for *delegation under law* of the powers of the State Legislature,
- the *political factors* in making a change over on a drastic basis have been duly considered and the various *facilitating* provisions can be made, and
- another factor with *political implications* relates to the valuation of owner-occupied properties versus the tenanted properties.

While for the purpose of determining the annual values, both would be treated alike, the “tenanted properties” would attract a surcharge, which could be fixed by the political executive, on a groupwise basis rather than for individual cases, thus eliminating the roles of the inspectors.

Rate Structures

(6) As a matter of overall taxation policy governing any municipal area, reforms of the tax base apart, the taxation policy must also concern itself with the *rate structures* and their application in different areas and for different assessees in any settlement hierarchy.

In this regard, it is noteworthy that wherever municipal valuations have been low, there has been a pronounced tendency to satisfy the revenue needs by imposing higher rates of taxes. Bombay provides a unique example in this regard where the following rates are being imposed :

**Rate Structure for Levy of Various Taxes by the
Municipal Corporation of Greater Bombay**

	<u>Non-Residential</u>	<u>Residential</u>
• General Tax (including 2.5% of Fire Tax)	28.50%	28.50%
• Water Tax	50.00%	100.00%
• Sewerage Tax	25.00%	50.00%
• Water Benefit Tax	12.50%	25.00%
• Sewerage Benefit Tax	6.25%	12.50%
• Street Tax	15.00%	15.00%
• Education Cess	8.50%	8.50%
• Tree Cess	0.50%	0.50%
Total	146.25%	240.00%

- (7) It is submitted that the proposed area-linked system would enable fixation of more realistic valuations which would ensure that the rate structures may also be kept at reasonable levels. The new system would also be amendable to cover the diverse situations from a metro city or a class I town down to a Panchayat.
- (8) Thus, with both *valuations* and *tax rates* being reasonable, it would be possible to tackle the present situation wherein the *taxation policies* of the Government are in direct conflict with the *economic development policies* for fringe areas, for dispersal of population, as the tax burdens in the fringe areas end up being higher than those in the inner city areas, at least, in Kolkata.
- (9) In the Indian context, there has been another weakness in the rate structures, namely, the slab systems as adopted for *ensuring progression* in taxes.

Thus, Bombay imposes taxes at a *uniform rate*, irrespective of the valuations which is basically inequitable.

Delhi used to follow the *progressive income tax system*, there being progressive increases over the highest amount paid in the previous slab. This system involved two *ad hoc* decisions at policy-making levels : one, the cut-off point for the various slabs and, second, the amounts by which the rates would increase in the subsequent slabs.

Several other Acts in India follow a slab system in which there are sudden jumps, at the cut-off points. This system was in vogue in Calcutta also before the enforcement of the 1980 Act.

At that time, an analysis of the tax demands in Calcutta under different valuation ranges showed that the taxes demanded from higher valuation properties within each range of each slab were lower than those from the lower valuation properties – a happening which is in direct conflict with the equity principles (see *Annex 13* for the analysis).

Based on an earlier study and its recommendations, this distortion was corrected in the Calcutta Municipal Corporation Act, 1980, by the introduction of the *Straight Line System*. It is noteworthy that Calcutta was losing as much as 12 per cent of its property tax revenue through this built-in defect of the system. This system has now been introduced to cover all the Municipalities in West Bengal also.

Therefore, the systems with built-in defects still in vogue in several cities need to be abandoned at the earliest opportunity and the Municipal Law proposes introduction of the *Straight Line System*.

Exemptions

- (10) As regards “exemptions” while the issues relating to the exemption of Central Government properties under Article 285 of the Constitution have been agitated for long, the latest developments are that the courts have held that even the *service charges* as presently levied are unconstitutional.

However, the Inter-State Council, at its meeting on 16th November, 2001 has recommended that Parliament may enact a law for the levy of property tax by Municipalities on Union properties.

- (11) The municipal properties, unlike in West Bengal, are also exempted from local taxes in many States. However, the 1980 Calcutta Municipal Corporation Act made a bold departure in this regard by bringing even the long term tenants of the properties of the Municipal Corporation under the tax net. Thus, sub-section (2) of section 193 provides as follows :

“(2) The consolidated rate on any land or building, which is the property of the Corporation and the possession of which has been delivered under any agreement or licensing arrangement, shall be leviable upon the transferee or the licensee as the case may be.”

This reform measure merits consideration by all State Governments.

- (12) Inasmuch as the municipal taxes are levied to mobilize resources for performance of duties under the municipal laws and not for taxing the incomes from properties, the issues may be raised whether the *occupiers, rather than the owners*, should not be made liable to pay the taxes.

For administrative reasons, it may be desirable to fix the liability on the owners. However, as has been provided under section 194 of the Calcutta Municipal Corporation Act, 1980, the tax burden can be shared between the owners and the occupiers. In the case of non-residential premises, it can be assigned to the occupiers only as has been done under the Calcutta Act.

Tax Mapping

- (13) In the matter of levy of taxes in India, whether Central, State or local, it is well known that *absence of tax mapping* is a critical issue.

While the objective of widening the tax net is of paramount importance, an issue which merits serious consideration is as to how should all those who are liable to pay taxes be brought on the assessment registers of various revenue authorities.

A new approach for tax mapping has to be very carefully conceived so as to eliminate the scope for any harassment of citizens who, tax liabilitywise, may not be subjected to the *inspector raj*.

An approach designed for this purpose by TRF is highlighted in *Annex 14* herewith.

Provisions Made in the Municipal Law*

- 30.** *Clause 135 provides for levy of a surcharge on the transfer of lands and buildings as a percentage of the stamp duty levied under the Indian Stamp Act, 1899.*
- 31.** *Clause 136 relates to a new levy, namely, “tax on deficits of parking spaces in non-residential buildings”, in Municipalities, as may be identified by the State Government.*
- 32.** *Clause 137 and clause 138 provide for levy of “water tax” and “fire tax”.*
- 33.** *Clauses 139 to 146 relate to various provisions relating to advertising taxes, including licensing of advertisement sites and an innovation of involving the advertising agencies for collections, particularly from bulk advertising spaces.*
- 34.** *Clause 147 provides for surcharge on tax on entertainment, clause 148 for surcharge on electricity consumption and clause 149 for tax on tourists and congregations.*
- 35.** *Provisions have also been made for tolls on roads, bridges, heavy trucks and buses under clauses 150, 151 and 152. Clause 155 provides for the Municipality to collect tolls in navigable channels also.*
- 36.** *A new chapter entitled “Commercial Projects”, under clause 166, provides that the Municipality may, either on its own or through public or private sector agencies, undertake projects on a commercial basis.*

* The Municipal Law does not provide for any legislative scheme for levy and assessment of property tax as legislative schemes for a number of models have been presented in this Policy Options Paper.