BRIEFING NOTES

to improve our understanding and ability to ask the right questions and take effective action on land matters in West Africa

"Land Tenure and Development" Technical Committee

Land tax

by Joseph Comby[1], February 2011

Annual land tax is one of the oldest and simplest of taxes, yet it has long been neglected in West African countries where land ownership is still viewed as a privilege. In this paper we are considering what is still seen as a taboo subject. Contrary to received wisdom, it is possible to introduce a basic annual land tax without a land register or a computerised system. This has been proved in many cases. While certain precautions obviously need to be taken to minimise the social impacts of land tax, it not only generates revenue for the locality but also discourages the unproductive retention of unused land, and in the long term helps secure the land rights of producers or residents by providing written proof of their occupancy.

Production coordinated by:

A tax as old as agriculture...

The annual tax on **agricultural land** is one of the oldest and simplest of taxes. It has existed for 4,000 years in Egypt and Iraq, and financed the construction of various European states. The tax on **urban lands** came later, progressively generating greater revenues than its predecessor as wealth creation moved from rural to urban areas.

The fact that many countries in the Southern hemisphere with very limited fiscal resources do not have land taxes, especially on agricultural lands, is a historical anomaly that can be explained by the combination of two factors:

- urban areas in these countries are often more reliant on imported food than locally grown products, which tends to be consumed on-farm and generates very little income;
- their economies are mainly based on exporting primary resources that are easy to tax (within the narrow margin that competition allows).

... not to be confused with the transfer tax

Land taxes, property taxes, development fees, registration fees, etc.: there are many different categories of tax, which raise money in two main ways:

- **annual taxes**: taxes, levies, duties, charges and contributions paid each year by the owners and/or occupiers of land and/or buildings
- **one-off taxes** charged when property is transferred (sold, given, inherited, shared) or during land registration procedures and planning applications.

While both types of tax support public budgets, they have opposite economic and social effects: the first (which are the focus of this paper) positive, and the second often counter-productive:

- **annual** levies encourage the productive use of land (and other property assets): people who don't cultivate their land and have to pay tax each year to retain it end up selling or renting it to someone who will use it productively. Similarly, the large number of vacant serviced parcels in certain urban areas in the Southern hemisphere can only be explained by the fact that they are not subject to any charges;
- **one-off payments** are often avoided as far as possible: they tend to discourage people from selling or at least declaring sales (or rentals), from applying for building permits, completing inheritance transfers or determining joint ownership, declaring forest clearances, digging wells, and so on.

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Tax the owner or the user?

Theoretically, insofar as land rent is freely negotiated between the owner and the tenant offering the highest rent, it makes no difference whether the tax is paid by the owner (who may or may not use the land) or the occupier (presumably the tenant). Either way, the owner will ultimately be responsible for the tax in terms of loss of income, as the rent will be lower if the tenant has to pay the tax. In economic terms, it could be said that *land rent* is a combination of the *rent* paid to the landowner and the *tax* paid to the government.

So the decision to tax the owner or the occupier is made on the basis of administrative convenience:

- in countries where there is a rigorous process for registering land transfers and the list of landowners in each locality is kept up to date, it is more convenient to tax the owners because unpaid taxes can be recovered when the land is next transferred, or the asset can be seized and put up for sale in order to recover unpaid taxes;
- conversely, it is much simpler to tax the apparent occupier in countries where the processes for appropriating or transferring land assets are less established; here, the only means of coercion is to seize any goods and harvest in the occupant's possession.

Taxing the apparent occupant is therefore the most convenient and effective option in countries in the Southern hemisphere. Land tax also has the additional virtue of providing annual proof of occupancy, thereby benefiting occupiers who wish to have their land rights recognised.

From a tax on land to a tax on capital

Taxes on agricultural and urban lands may be separate or interconnected, depending on the country and period concerned. They may also constitute a single fiscal system in which all land assets are taxed (as with *property tax* in the United States), or be incorporated into a broader tax on all of the taxpayer's capital.

The tax on land and ground is obviously the best starting point because it is simpler to implement, and can then be developed in various ways.

In urban areas the relationship between taxes on land and taxes on buildings also needs to be addressed. The French solution of taxing undeveloped land on the one hand, and buildings and their sites on the other developed for purely historical reasons; this model has created needless problems when applied to urban areas in the South.

It would be simpler to have a flat-rate tax on all property assets, with developed land assessed per square metre of floor space for each type of building and neighbourhood, and undeveloped land assessed per square metre for each neighbourhood. This would mean that no asset would be taxed at less than its potential value as undeveloped building land, however run down it might be.

National or local taxes?

For many years land tax was a national tax, assessed by *dividing* the expected proceeds of the tax between each province and requiring every village to contribute a certain share of this sum. In each village an appointed leading citizen, village council or civil servant (or combination of all three) collected this money from landholders on a pro rata basis, according to the amount and quality of land they held.

An additional sum was often collected on top of this to fund local government expenditure.

Nowadays, with the notable exception of the communist Chinese State, this seems to have become a local tax, since land is the most *localised* of all assets. It is easier to tax incomes (whose localisation is not clear) and the movement of goods at the national level.

It is worth noting that the establishment of local democracy is often linked with successful local management of land taxes, and that municipal politics still largely revolves around discussing the amount of tax to be raised to pay for public services. Without the freedom to raise taxes, local democracy is severely handicapped.

Of all the taxes, land tax is also the most equitable and least open to fraud, especially if the tax roll and charges are made public.

Tax based on market value or rental value?

In a market economy, the two solutions are theoretically equivalent, as the rental value (the amount that land can be rented for) tends to be proportional to the market value (the amount that it can be sold for): the *rate* will change but the *proceeds* of the tax will be the same.

For historical reasons, land taxes in European countries are based on rental values because very little land was sold when these taxes were created; renting was much more common and rental rates were better known. In countries like Canada, the United

States and Australia, which never had big landlords, land tax is based on market values.

This second solution is preferable in most Southern countries where leasing contracts are rare and relatively insecure.

Flat-rate or case-by-case assessment?

Individual assessments of each land asset are only used in countries that expect to get a high return on their land tax (for example, in Quebec, where land taxes are very high, all assets are re-evaluated every three years). Governments elsewhere rely on *mass evaluations*: simply classifying assets by type and zone, and adopting a *flat rate* per square metre for each type and zone of the tax base.

One classic old method consists of choosing a representative example of each type of land or building with a known value in a given geographic sector. A commission (or one or two experts) then classifies all the other goods in the sector according to how much they are similar to the retained examples.

Is a land register necessary?

"Land registers" were originally simple lists of taxpayers. Cadastral maps were introduced in the 18th century in order to distribute the tax burden more equitably. Until then, a list of taxpayers was compiled for each locality, along with the approximate area of their holdings, often expressed in the number of days required to cultivate it. In France, the principles of land tax were laid down in 1791, although it took 60 years to complete the first generation of cadastral maps.

Now that aerial or satellite photographs can be used to identify landholdings and evaluate their approximate size, it is no longer necessary to undertake such a huge task. Benin's *urban land register*, which is often cited as a model, began by recording parcels on a simple town plan of Cotonou. Topographic surveys were conducted later, but they proved costly and did little to improve the efficiency of the tax system.

A simple system of allocating addresses in urban areas, as proposed by the World Bank, is much less expensive than a cadastral plan, and can provide the basis for a rough land tax based on visual and aerial identification of the assets at each address. It is absurd that the topographic surveys undertaken to provide further details about the tax base cost more than the extra tax revenues they generate. They are often inaccurate in poor countries; and in any case, even the most perfect land register quickly becomes obsolete and useless unless there is a rigorous system for updating it.

What is the optimal level for annual taxation – what rates should be charged?

The **lower limit** of the land tax should be determined by how much it costs to collect. For example, it would be unreasonable to levy a tax whose proceeds do not amount to at least twice the total cost of its collection. It is generally considered acceptable for administrative costs to amount to about 10% of the proceeds of the tax.

The **upper limit** simply depends upon how much the asset could enable the taxpayer to contribute if it was used most profitably. If there is a risk that this kind of upper limit will be less than the lower limit, the tax should not be extended into the sector under consideration. This is the situation in many rural areas in countries in the Southern hemisphere, which exist on the margins of the market economy.

In practice, a rate of around 1% of the real potential market value is acceptable in geographic sectors where a land market already exists (in fact, if not in law).

The role of land tax in securing tenure

Annual land tax can play a positive role in securing land rights:

- by introducing the idea that ownership is as much about obligation as privilege;
- by discouraging unfounded claims to get ownership recognised (no-one is going to bribe a civil servant for the right to pay tax);
- by automatically requiring to land occupancy surveys and providing residents with proof of occupancy in good faith (receipts for annual payments).

Should tax be differentiated according to land use?

In order to encourage investment, many developed countries are introducing an incentive into their land tax by offering exemptions of varying lengths for new constructions, irrigation and drainage works, laying on services, etc.

These arrangements are complex to manage and are not suitable for countries without effective administrative systems, where they risk doing little more than opening the door to corruption.

Social and political risks

Although they are nearly always economically effective, land taxes can be difficult to manage politically because they are less painless than indirect taxes or customs duties. This means that they need to be introduced gradually, starting with the richest territories and applying modest rates that are then increased pragmatically, according to the results obtained. It is particularly important that the public accepts the system, so people need to be able to participate in deciding how tax revenues are used and in managing them (cf. Latin America).

There are also social risks associated with land tax. For example, in a region dominated by an under-monetarised peasant economy, the sudden introduction of a land tax will drive the poor off the land and only benefit businesses.

However, forward planning and social justice can lead to a progressive land tax. One way of doing so would be to decide that the first X square metres of land cultivated by a family are not taxable, and applying the same rule to housing so that the poorest members of rural and urban populations do not have to pay anything.

Unlike annual land taxes, taxes on the sale of land can create legal insecurity, especially in poor countries where people tend to put off registering changes in tenure in order to avoid paying tax.

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