

REFORMING THE PROPERTY TAX BASE

Need For A New Direction

Amaresh Bagchi

1. Introduction

For various reasons, the tax on urban lands and buildings—the property tax (PT)—which constitutes the primary source of revenue for urban bodies all over the world is in doldrums in India. The revenue productivity of the tax has staggered far behind the potential signalled by the growth of cities and the phenomenal increase in the prices of urban real estate. In the perception of taxpayers on the other hand it is a most oppressive and iniquitous levy, with the tax base often capriciously assessed and the rate of tax perched at absurdly high levels (over 100 per cent of the rateable value in some cities, e.g., Mumbai for commercially used properties). Factors underlying this state of affairs mainly are twofold—one, judicial rulings tying down the base of the tax to the norms of standard rent as laid down in the rent control laws of the land which in most situations do not bear any relationship to the prevailing market rents and open up opportunities for abuse through multiple tenancy and other devices, and two, the absence of an open market for real estate in the country because of the widespread practice of under-reporting rents and capital values in real property transactions to evade taxation. The problems have been compounded by the weaknesses of the administrative machinery, general laxity in monitoring and supervision, and tortuous legal processes in settling disputes.

Various suggestions have been put forward from time to time to reform the system. Of these, the one that has attracted wide attention seeks to standardize property tax assessments by laying down norms of rental values per unit of plinth area instead of depending on notionally determined rental values. A plinth area rooted base, being verifiable, it is argued, will not be amenable to any manipulation or abuse, since the assessments can be simply made by using some pre-determined standards of rental value related to verifiable physical characteristics of a given holding with bearing on its earning potential such as area, location, type of construction, use, and so on. It will also have the merit of transparency and

simplicity. Models for standardised PT assessment for urban bodies in India have been put forward in Kapoor (1977), Ramakrishna (1980) and ORG (1979). More recently a specimen draft bill for a *Composite Area Linked System of Property Tax in India* has been presented in Kapoor and Ghosh (1990).

Initially, despite sustained pleading from its proponents, reforms towards an area-based system of property taxation could not proceed far because of constitutional constraints that mandate equal treatment of equals under all laws of the land and, as a corollary expounded in judicial pronouncements, forbid schemes of taxation that rely on uniformly applicable standards and do not differentiate "reasonably" between taxpayers with varying taxable capacity.

Of late, however, there has been a change in the judicial approach to the question of reasonableness of classification in the context of taxation. In a recent judgement, the Supreme Court (SC) has upheld the legality of a scheme of standardized taxation of properties by the Patna Municipal Corporation.¹ Emboldened by this pronouncement, advocates of standardization are pleading for the adoption of a standardized base for property taxation throughout the country and several states are known to be contemplating reforms of their PT in that direction. While acknowledging the urgent need for reform towards some standardization and reducing the scope for subjective judgement and abuse, this paper seeks to draw attention to the limitations of the models that have been put forward for replacing the existing base for the PT with a non-transparent area-based system and the need for moving towards a base, such as, capital value which is more amenable to standardization and is not likely to give rise to troublesome questions about adequacy of classification and so on. A properly devised capital value base, it is further argued, would serve to capture the chief merits of standardization in conformity with the canon of equity as enshrined in our Constitution.

We first go over the key features of the existing system and its major weaknesses (Section 2). This is followed by a brief account of recent initiatives for reform and a critique of the models proposed (Section 3). Section 4 explores the directions in which a new tax base can be evolved for property taxation which will achieve the desired objective without running foul of the law. Section 5 concludes.

2. The existing system and its infirmities

The problems arising out of the present system of PT in India have been extensively studied and are well documented (NIPFP 1981; Datta 1983; Delhi Administration 1990). However, it may be useful to discuss briefly the key features and the problems with the system that has been operating in the municipalities of India as a backdrop for recommendation of possible remedies.

Following the British tradition, the base for taxation of urban properties in India has been a notional concept, typically, "the annual rent at which such land or building might reasonably be expected to let from year to year", after allowing for certain deductions such as cost of repairs, insurance etc.² Although the laws relating to levy of the tax usually do not specify how "reasonable rent" is to be estimated, the presumption has been that in the case of rented properties, the rent actually paid by the tenant could ordinarily be taken as "reasonable". For owner occupied premises, rents prevailing for similar properties in the locality provide a basis for judging what could be taken as reasonable rent. Generally, no distinction is made in the law between self-occupied and tenanted properties. On the face of it, the system should have helped to ensure equity in PT as all classes of property would come under uniformly applied principles. In practice, however, this has not happened and the PT system has developed distortions in several directions giving rise to complaints of acute inequity as also inefficiency in the use of urban space, a most valuable resource of the community. There are several factors responsible for this, the most important single factor being attributed to the constraints embedded in the rent control laws.

Following the ruling given by the SC in 1970 in the case of Corporation of Calcutta vs. Padma Devi³, it came to be established that in judging what could be considered reasonable rent in the context of property taxation, one has to go by the limits set by the concept of "standard rent" in the rent control laws of the land. When the standard rent for a holding is fixed by the rent controller, the court ruled, the rateable value (RV) cannot go beyond the standard rent. This principle was then extended in successive judgements to situations when the rent was not fixed by the rent controller, even if under the relevant rent law it was lawful for the landlord to let out his house at rents higher than the "standard"

prescribed in the rent control legislation.⁴ Finally, "standard rent" was set as the upper limit for assessment of RV even for self-occupied houses and it was further enjoined that when the standard rent looked too high and was unlikely to be earned by the property in question for any reason (such as size, state of repair) its RV must be determined on such lower rent.⁵ The base of the PT, thus, came to be confined for all practical purposes to the lower of standard rent or the rent reported to have been actually received by the landlord.

As is well-known, this principle has had a disastrous impact on the yield and equity of the PT. The yield suffered because, earlier the "standard" fixed for rent under the rent control laws did not bear any relationship to the earning potential of the property especially since no revision was permissible once a holding was let out on rent. This resulted in freezing the PT base on the one hand and gross disparities in the incidence of PT on the other because the standard rent even for properties in a given locality with identical characteristics differed widely depending on the date on which they were let out or when their construction had commenced. Sometimes, the tenancy leases were set up on absurdly low rents and abrogated in no time to establish new tenancies at much higher rent, simply to get the PT assessed at a low figure. Rents were split through the device of multiple lease agreements and the actual rents remained submerged. It was not surprising, therefore, that assessment ratios (the ratio of RV per unit area to comparable rent) averaged only 20 percent in New Delhi municipal areas as of 1989—90 (Delhi Administration 1990; Bagchi 1991).

The PT base in many cities got dented or frozen even before it came to be entangled in rent control laws. This was particularly the case with self-occupied houses for which the assessments were frozen through guidelines which debarred any upward revision except in the event of additions or alterations. The ills of the PT system were compounded by administrative weaknesses and lapses. Because of poor coordination between the building department and the assessment division, information regarding new properties did not percolate to the assessors for a long time leaving wide gaps between the number of properties in existence and those assessed to PT. In several cities (e.g., Delhi and Bangalore) the properties assessed to PT hardly form 50 percent of the actual number. A part of the gap is no doubt attributable to the exemptions given to small holdings but a considerable number is made up of structures illegally erected or awaiting completion certificate. Not, unoften,

properties are occupied without any occupation certificate. The tax being leviable only on the owner, in many cases the assessing authorities are unable to proceed because of problems in tracing the real owner, with properties changing hands—often several times over—through general powers of attorney (GPA).

3. Initiatives for reform

The need to improve the PT system is widely recognised and the matter has engaged the attention of policymakers across the country for quite some time. Initiatives have also been taken in the area in several states and cities. The thrust of the initiatives has been twofold: one, to contain the mischief of rent control by introducing a *non-obstante* clause in the municipal tax law (that is "notwithstanding anything contained in any other law"); and two, to move away from notional annual rental value (ARV) for deriving the RV to a standardized area-based system of assessment.

The attempt to get around the rent control stipulations through a *non-obstante* clause in the municipal tax laws has been upheld by the SC but after a long period of uncertainty. In the first case involving the interpretation of a *non-obstante* clause in one municipal PT law that came up before the SC, the court held that where the law contained such a clause, if the standard rent had been fixed, and there was nothing to show fraud or collusion, it could be taken as the reasonable letting value "but where the building has never been let out and is being used in a manner where the question of fixing its standard rent does not arise, its reasonable rent can be fixed without regard to the provisions of the rent control law (Municipal Corporation of Indore v. Ratna Prabha & others)⁶.

This ruling came under some cloud with the SC observing in a subsequent case which arose under the *Punjab Municipal Act 1911*, as applicable to Delhi and the *Delhi Rent Control Act 1958*, "...it is rather difficult to see how the *non-obstante* clause in that section can possibly affect the interpretation of the words annual value of any building shall ... be deemed to be the gross annual rent at which such building might ... reasonably be expected to be let from year to year".⁷

The reservations expressed by the court about the correctness of the decision in the Ratnaprabha case, however, came to be questioned by the SC itself in subsequent cases. In one case the court observed: "... we feel compelled to express our doubts as to the soundness and continuing relevance of the view taken by this court in several earlier decisions that the property tax must be determined on the basis of fair rent alone regardless of the actual rent received."⁸

Finally, in a more recent judgement,⁹ relating to the property tax law of the Ahmedabad Municipal Corporation, the SC has reaffirmed that where there is a *non-obstante* clause and the standard rent is not fixed, the actual rent received shall be deemed to be the annual rent on which the property might be expected to let. This no doubt would appear to have strengthened the hands of municipal tax authorities to steer clear of rent control laws, with the help of *non-obstante* clauses in their laws. But, as will be seen from the discussion that follows, so long as rents are subject potentially to come under the rent control, the shadow of rent laws still stalks the PT system based on annual rentals and there is no way of getting around them unless the base of the tax moves away from the RV.

Relying on "actual rents" also may not be the answer to the problem of depressed PT base when, as in India, the practice of concealing the true consideration for letting out a property and keeping the reported rental down through all kinds of devices happens to be widespread. The power usually given to the Commissioner to estimate fair rent in cases where the reported rent is *prima facie* collusively fixed has not helped matters. The initiatives to standardize the base with the help of "norms" reflect the frustration arising from these practices, the inability of tax authorities to tackle them effectively and the anxiety to delimit the scope for discretion and the arbitrary assessments and abuse, associated with the notional fair rent concept.

The idea of an area-based PT to remedy the ills of the rental value base was first put forward by Kapoor (1977). In Kapoor's scheme, there would be a "land tax" and a "building tax" on the basis of area measurement, with zone-wise variation and additional cesses for non-residential use, and surcharges for developmental purposes. Periodic reassessments would be done away with and only the rates would be changed with changes in population density. The

area-based approach was given concrete shape by ORG (1979) and Ramakrishna (1980). Apprehending that a tax levied only with reference to plinth area might be questioned on equity grounds, Ramakrishna suggested that in fixing the rates of tax, account should be taken of other relevant factors, such as, location of the building, construction type and nature of use and age. In his scheme, there would be a basic tax related to plinth area or carpet area, and "extras" related to location, type of construction, use, age etc. Based on the published figures of basic tax, property holders would be able to assess their own tax. This system, it was argued, would eliminate discretion, while periodic revisions could be made simply by varying the basic rates and the "extras". The "extras" could also help to achieve the desired degree of progressivity. Time and effort involved in periodical reassessment would thus be saved.

The idea of area-based taxation has been propounded assiduously by the *Times Research Foundation* and a specimen draft bill for implementing a *Composite Area Linked System for Property Tax* has been drawn up under its sponsorship (Kapoor and Ghosh 1990). The idea has received a boost recently from the judgement of the Supreme Court upholding a scheme of standardized area-based taxation in the Patna Municipal Corporation (State of Bihar v. S.K.P. Sinha).¹⁰ However, tax schemes framed on standardized assessments still have to contend with questions about equity and transparency, and hence, legality, all of which are not resolved yet.

The basic problem is that standardization conflicts with the criterion of equity. As mentioned at the outset, our Constitution guarantees equality of all before law (Article 14) and it is well settled through judgements of the SC that this implies equal treatment of equals and as a corollary, adequately differentiated treatment of unequals. All laws in the land including tax laws have to abide by this rule. Some latitude has been allowed to the legislature in this regard, but the upshot of the rulings so far has been that, while absolute equality is not to be expected, there has to be a reasonable classification, among taxpayers in dissimilar circumstances if each class is to be treated as a homogenous group. Because of absence of reasonable classification several tax legislations seeking to introduce uniformity or standardization in taxation were struck down by the courts as *ultra vires* the Constitution.¹¹

The decision of the SC in the Patna case seems to signal, for the first time, an inclination on the part of judicial authorities to endorse standardized PT assessment as legally acceptable even where the classification does not go very far. However, for several reasons explained below it would be premature to conclude that standardized PT assessment has finally received the judicial approval.

First, the main consideration which seems to have prevailed on the SC in upholding the legality of the Patna scheme was its simplicity. What the system introduced in Patna had done, briefly, was to reform the system of PT assessment radically by replacing the annual rental value base assessable on the basis of reported actuals or what is tenable under rent control parameters with a standardized value, per unit plinth area. For this purpose, rules were framed laying down the following criteria for assessment of the tax viz., (i) location of the holding, (ii) use, (iii) type of construction, and (iv) carpet area. The total area of the town was divided under three categories (i) as on principal main roads, (ii) main roads, and (iii) all other roads. The buildings in each of these locations were further again classified under three categories by construction type viz., (i) *pucca*, with RCC roof, (ii) *pucca* with asbestos or corrugated sheets, and (iii) others. Further classification into three groups was made according to use, viz. (i) commercial or industrial, (ii) residential, and (iii) all others not coming under any of the first two categories. The classification table was thus made up of a "three by three by three" matrix that is, consisting of 27 categories. The annual RV per square foot (that forms the basis of RV of a holding) for each category was notified by the corporation. Simultaneously the rate of tax was slashed from 43.75 percent to just 9 percent of the ARV.

A Division Bench of the Patna High Court before whom the rules came up for consideration, while appreciating the practical advantages of the new system over the previous mode of determining the ARV, held them violative of Article 14 of the Constitution (viz., the right to equality under the law) because of inadequate classification. The court felt that the classification by nature of construction needed enlargement under more heads and sub-heads and other features, such as, the finishing quality, appurtenances, provision, conveniences and facilities available (Singh 1996). On an appeal of the State of Bihar, the SC overturned the HC ruling, observing that the earlier system left too much discretion in the hands of the

assessing officers. "A new system, with all its good intentions was being tried out—a system designed in the interest of the body of houseowners, taxpayers as well as corporation" and "unless found to be offending the constitutional or statutory provisions, it must be allowed to be worked out."¹² It was argued that the HC's direction regarding more elaborate classification was unworkable and inimical to the simplicity of the scheme.

While the considerations which apparently weighed with the SC in overruling the HC are unexceptionable, with utmost respect to the judges of the apex court, it is submitted that the judgement needs reconsideration as it overlooks patent inequities and arbitrariness of the Patna scheme. It is pertinent to note two points; one, while one cannot expect absolute equality in tax matters, and classification cannot be carried beyond a point, the doubts expressed by the Patna HC about the equity of the simplified Patna scheme and the suggestions made by the court to meet them cannot be easily dismissed as much too perfectionist or impracticable. While for purposes of property taxation there can be no objection to divide up the different areas of a given city into more or less homogenous zones, to regard all locations adjoining all "principal roads" or even on a given principal road on equal footing does not quite stand to reason. To take the example cited by the Patna HC, one of the "Principal Roads" in the city viz., *Ashok Rajpath* runs through different parts of the city, some old, some new. To assume that all holdings on this road (whether in the commercial class or in the residential category) would have the same rental value regardless of whether they are situated in the new city or in the old city is obviously unjustifiable. Then 24 main roads with cities were put under the "Principal Roads" category, 88 under the category of "main road" and the rest were placed under "others" (Sinha 1996). Those familiar with the layout of the city under the Patna Municipal Corporation would agree that the HC was not unreasonable in observing that a road like *Ashok Rajpath* can only be handled properly by dividing the city into different zones. It would be premature to think that the SC judgement overruling the Patna HC in this case has put an end to all these controversies. The SC has allowed the Patna scheme to work on a trial basis and the doubts raised by the Patna HC are likely to come up again especially when the revision of the standard values becomes due. Meanwhile, the problem posed by rent control also remains. For, in the Patna case, the SC has made it very clear that it did not go into the question as it had not been raised before the HC.

That the standardization of PT base is not yet out of legal woods may be seen from the fact that attempts by the Municipal Corporation of Delhi (MCD) to have the ARVs assessed on the basis of norms of prevalent rent have run into difficulty. In order to reduce arbitrariness and abuse, and following the recommendations of a high-powered committee on PT in Delhi, the MCD has framed byelaws that in the case of rented premises, the actual rent will normally be taken as the annual rent for ARV purpose. If however, "the Commissioner has reason to believe that the declared rent does not represent the prevalent rent in the year of letting and the difference between declared rent and prevalent rent is more than twenty five per cent of the declared rent, the annual rent shall be the prevalent rent".¹³ An explanation to the relevant clause provided that "the prevalent rents shall be determined by a "panel of assessors to be appointed zone-wise by the Commissioner". The panel was to include a representative of the government, the corporation, one from an external tax department or a valuer, and a representative of the property owners of the zone.

In a judgement delivered in 1995, the Delhi HC has struck down the explanation on the ground that it "binds the assessing officer to determine the prevalent rent on the basis of a panel which is not permissible".¹⁴ The HC has held the "explanation" bad in law also in view of the powers given by the Delhi Municipal Corporation Act "to employ valuers to give him advice in connection with the valuation of any land or building."

Attempts to standardise PT assessment in Hyderabad on the basis of predetermined RV per unit of plinth area have run into similar problems. In order to reduce the area of discretion and facilitate self-assessment, under rules framed in 1990 the entire municipal corporation area of Hyderabad was divided into 90 zones based on civic amenities, proximity to markets and shopping centres, educational institutions, banks, post offices, hospitals, factories, and industries and "such other relevant factors". Buildings in each zone were classified under six categories, according to the type of construction (e.g., RCC posh buildings, RCC ordinary buildings). Holdings were further classified under six categories, taking into account the nature of their use (residential, shops, public use, commercial use etc.). A 6X6 matrix with 36 categories was thus set up for each zone. Rent "fixable" for each category was to be decided by the Commissioner for each category of building per square meter of plinth area, drawing on survey data. Rents were to be fixed provisionally and

notified to invite objections, if any. District level advisory committees were to be constituted by the state government to assist the Commissioner in this task. These rules have been struck down by the Andhra Pradesh HC with the observation that when an assessee files any objection to the assessment proposed on plinth area basis, "the Commissioner has to decide those objectively without fettering discretion because of the determination already made on the basis of the plinth area method." The court has held that (i) the power for determination of and rental value of the buildings and the PT belongs to the Commissioner and cannot be fettered by rules framed under the Act and (ii) the committee constituted by the government has no role to play and the Commissioner is not bound by their recommendations.¹⁵

While it is ultimately for the SC to pronounce on the legality of the scheme designed to standardize the PT base, the fundamental problem with these schemes is that they tend to gloss over glaring differences between holdings in the name of simplicity for lack of adequate classification and when they seek to provide for elaborate classification, the manner in which the ARVs are fixed remains obscure rendering the tax or value fixed open to charges of arbitrariness. How exactly the *inter-se* variations were worked out between the 36 categories of holdings in each zone and those with similar characteristics between zones in say, the Hyderabad city, is not known. How obscure the process of norm fixation can be in standardized assessment schemes is best illustrated by the "formula" for PT assessment in Ahmedabad. Under the formula, $PT = \text{rate} \times \text{area (in sq. ft.)} \times (f_1 \times f_2 \times f_3 \times f_4)$ where f_1 relates to type of usage, f_2 to location, f_3 to age of construction, and f_4 to residential type. Non-residential buildings again are assigned factors ranging from 1 to 8. The tax payable for a given holding is determined by multiplying the rate prescribed per square foot by the factor, as worked out with the formula.¹⁶ The *inter-se* differences between location, construction types, it may be argued, are based on survey data but that presumes availability of reliable data on the rents actually prevailing in all localities, which can account for not only differences in location, but also type of construction and use. Even if reliable data are available, to allow for variations in all the six by six categories as in the Hyderabad scheme in a transparent manner is not simple.

As pointed out by the critics of area-based standardization, the idea that the value of a property can be derived as a discrete function of five or six attributes like location, type of

construction, usage and age, in a linear combination is erroneous. It is a "hedonic formulation of property values" as Rakesh Mohan (1983) put it. While it facilitates administration, it is doubtful if it is less anomalous or arbitrary in its operation since determination of zones and assignment of weights to the specified criteria calls for a lot of discretionary effort (Jha 1980; Rakesh Mohan 1983). How arbitrary PT assessment can become is illustrated by the experience of Jakarta where properties are valued on the basis of an index table providing for classification according to zone, use and infrastructural facilities (Linn 1976). The so-called *Composite Area Linked System for Property Tax in India* proposed by Kapoor and Ghosh (1990) also suffers from the same infirmities. In fact, their scheme illustrates how arbitrary and conceptually confusing area-based thinking on PT can be. It is difficult to make out from the Kapoor-Ghosh formula what exactly they have in mind while talking of "annual value". Is it the ARV or do they have essentially capital value in mind? If it is the latter as one gets the impression can it be called "annual value"? The paper does not address the question at all.¹⁷ Combining all factors that influence property rentals into one, unavoidably calls for attaching weights even if implicitly and that in turn is bound to bring in subjectivity.

A little reflection would show that the task is particularly formidable when the characteristics in three or more dimensions are sought to be converted or combined into one value. These questions will assume heavy proportions when revisions are undertaken and there can be no gainsaying that periodic revisions are essential if PT revenue is to acquire some buoyancy. As observed by the Andhra Pradesh HC in the Hyderabad case, the rules laying down the various criteria to be kept in view for assessing the ARV should be read only as "enabling guidelines" to arrive at working figures and not as binding.

The fact of the matter is that standardization of PT assessments is not possible in a demonstrably equitable and sustainable manner so long as the ARV continues to be the base. As argued below, if the merits of standardization are to be captured without giving grounds for doubts about equity, it is necessary to move away from the ARV base towards a PT system based on capital value.

4. Case for a capital value base

While the need for some standardization in PT assessments is indisputable, the objections mentioned in the preceding paragraphs can perhaps be met to a great extent if the burden of classifying properties according to the characteristics that can exert an appreciable influence on their taxable capacity is lightened by dealing with each characteristic separately instead of trying to combine them into one value through a "composite" formula. This is possible if the classification according to location is taken to determine the land value and the variations in building value because the differences in the type of construction are looked at separately. Differences in taxability attributable to usage (residential, non-residential, commercial, industrial, etc.) can be taken care of through variation on the rates of tax. Such a scheme would require a radical shift in the base from annual rental to capital value.

Although in equilibrium and with perfect foresight the capital value(CV) of a property should reflect the discounted stream of its income—in the real world where uncertainty, urbanisation, and operation of influences on property value from many directions which cannot always be foreseen, the two values, capital value and discounted present value of rentals may not correspond. However, where incomes are rising, capital values tend to move ahead of annual rentals and so, with regular reassessment, a CV base offers a more elastic revenue source than ARV. The other advantages of CV are: it facilitates taxation of vacant land, formulation of an elaborate valuation code and synchronisation with central taxes that require capital valuation. It is also less amenable to evasion (Mohan 1983). These merits notwithstanding, ARV has continued to be favoured as the base for PT in India primarily because of the absence of an open real estate market and the gross underreporting of amounts paid in real estate transactions. It would also not help to circumvent rent control because capital valuation has to proceed on the basis of legally maintainable rent. Adjustments have also to be made to allow for different types of property rights (e.g. leaseholds), eliminate excessively low or preferential values, or prices reflecting "hope or development" value and to neutralise the effect of any subsidy or tax advantage on house prices (Foster, Jacknan and Perlman 1980). These were among the major reasons for which the recommendations made by the Layfield Committee (1976) in UK did not find favour for a long time.¹⁸ After a comparison of various alternative bases, a NIPFP study on PT reform in West Bengal also came out in favour of retaining the ARV base (NIPFP 1982).

A more recent study of urban public finance in developing countries however has discovered that while there is no optimal PT structure for urban local governments in the countries surveyed, there is a clear trend in PT practices in the developing world away from the annual value base and toward CV assessment (Bahl and Linn 1992). An important factor underlying this change seems to be that PT based on annual value is unable to meet the demands on the local tax systems in the face of rapid urbanization and increasing demands for civic services. Horizontal and vertical equity are better achieved with a CV base. It is also useful as an instrument for influencing intensity and spatial distribution of land use and in capturing the land value increments flowing from urbanization. Furthermore, growth of owner-occupancy and more diversity in the housing stock on the other hand reduces the advantages of mass assessment of rental properties—an important merit of the ARV base—which are available when they happen to be homogeneous. According to the authors of the study, the reason why ARV still continues to be retained in some countries is simply inertia, besides probably the higher administrative costs of CV assessment.

Most of the factors mentioned by Bahl and Linn (1992) as driving the change towards the CV base seem to operate in Indian cities too. An additional and no less weighty reason for giving serious consideration to the adoption of CV base in the Indian context is that it would help to standardize the valuation in a more acceptable way from the equity level as well as revenue angles than has been possible with the ARV. This is because, land values have been (and are being) standardized in several states in India (e.g. in Tamil Nadu, Andhra Pradesh and Karnataka) for purposes of stamp duty and registration fee. The basic value of land in cities as well as villages are laid down for different areas, and zones are set up on the basis of regular surveys and periodical revisions. There is a *Central Valuation Board* functioning in West Bengal for some time now and in a recent meeting of the state finance ministers it has been decided to set up a central valuation cell in every state to lay down norms and evaluate properties in order to facilitate the administration of stamp taxes.¹⁹ As for buildings, engineering norms for the construction cost of different types of buildings are laid down regularly by the public works departments and in any case can be set up easily by any central valuation authority with the help of trained engineers. As mentioned above, differences in property values because of usage are better taken care of through variation in the rates of tax rather than through "weights" thereby taking the load off from standardization

in securing equity in respect of an important factor. Standardization of CVs with adequate classification for these two basic characteristics, viz., location and building type will not raise the kind of questions about equity or transparency that come up when properties are valued by using norms or factors derived through big matrices, such as, in Ahmedabad (while if the classification is too brief, as in Patna, inequity becomes palpable). CV, it may be added, constitutes the base for taxation of vacant land and for holdings like cinema halls, hotels, etc. under the existing laws of PT in most municipalities although for properties in general, the tax is levied on ARV base.

In the interest of transparency and fairness, it will still be necessary to constitute advisory bodies like zonal committees consisting of experts to set up norms of land values and construction costs, publish them to provide an opportunity for objections from the public and also allow an option to taxpayers to contest assessments, though only on grounds of misclassification or mismeasurement. Even so, the scope for arbitrariness and abuse will be very much reduced.

Substitution of CV for ARV, it may be argued, will in no way help to get around the problems in PT stemming from the operation of rent control as constraints of "fair rent" and the tenancy rights affect capital values. While these arguments cannot be brushed aside, it needs to be recognised that a PT levied by a local authority is **not** a tax on net wealth but an instrument for raising revenue to meet the costs of civic services provided to its residents which cannot be charged individually because of the generalized nature of their benefits. The intrinsic capital value of a property, irrespective of the nature of the respective rights of the owner or holder and the occupier or tenant can, therefore, legitimately be taken as the base for property taxation. However, in equity, it would be necessary to apportion the liability for the PT between the owner/holder and the occupant and following the practice obtaining in many municipalities and corporations; the proportion may be fixed at fifty:fifty. Such sharing and as a corollary, a right to the tenant to contest assessments has been recognised as legitimate by the courts. Once the principle of sharing is established by law and the property owners are empowered to pass on the additional tax burden if any resulting from assessment on a new base to occupiers terms of tenancies will adjust to the new tax regime. Where the owner cannot be identified—the onus of identifying the owner should be on the occupier vis-

a-vis the entire liability for the tax should be on the occupier. This will be an effective remedy for properties passing several hands through the GPA. Where a holding is occupied partly by the owner and partly tenanted, or where the holding is let out for mixed use, such as, partly commercial and partly residential, the CV can be apportioned between different uses, to be subjected to the levy at the appropriate rates for each, with a right of appeal to the occupier.²⁰

A variant of the CV base could be a rateable value derived by applying a presumed rate of return (say 8 or 10 percent) to the CV estimated on the basis of standard values of lands and buildings. This would have the advantage of familiarity with the annual rental value concept. Essentially the two approaches might appear to be equivalent, as the difference surfaces only in the tax rates (e.g. with a 10 percent rate of return, a tax at the rate of 15 percent of the ARV works out at 1.5 percent of the CV). In order not to run foul of rent control laws, it is however, advisable to go over completely to the CV base rather than cling to ARV simply because of familiarity. Besides, what would be justifiable or maintainable rate of return in a given locality or for a given property would remain a moot question. A system of PT levied on the imputed income of urban real estates was in vogue in Spain for a long time. The income was calculated as a fixed percentage of the cadastral (land and building) value. This system was changed in 1988 and now the tax is levied as a prescribed percentage of the CV as assessed by the State, but not exceeding the market value. The tax rate is decided by the municipalities but is subject to a general minimum of 0.4 percent and a maximum of 1.3 percent, depending on the population of the municipality (Santigosa 1993).

It is noteworthy in this context that the PT system in England of which the ARV based PT in India is a legacy, has undergone radical changes in recent years. After a disastrous experiment with the "poll tax", to replace the earlier "ratings", local governments in the UK have introduced what is called the *Council Tax* for "domestic" holdings. The council tax is nothing but a property tax based on banded on capital values with discounts for single adult households and certain other limited categories of persons.²¹ (Gibson 1993). The scheme of council tax proceeds by setting up eight bands of CV and establishing a mean capital value for domestic properties and then placing each property in one of the bands. The tax is assessed first by fixing the amount payable in the middle band (Band D).²² For properties

falling in the other bands, the tax is assessed by applying the prescribed proportions to the tax fixed for the middle band. Progressivity is achieved by varying the proportions which range between 0.67–2 percent. Properties were valued rapidly for the council tax without going too much into detail. In fact the whole exercise was carried out somewhat superficially, in order to determine their bands (Watt 1995). Although the system seems to provide a rough and ready method of taxing dwellings, there has been little objection as the variations in the tax bills are much less than those in valuations (King 1993, Banerjee 1994).

It would no doubt help a great deal to even out errors in valuation, if after estimating their CV, using the standards of land values and constructions cost, properties are placed in "bands" as under the council tax in Britain. But that would require a switch from rental to capital values in the first place. Besides, given the history of judicial pronouncements rulings pertaining to the norms for classification in India one may adopt only some of the features of the council tax, particularly the rough and ready method of valuation of lands and buildings, fixing the tax rate within a range of 0.5 to 2 percent of the CV. The decisions of State finance ministers to set up central valuation agencies in each state provides a good opportunity for reforming the PT base in a new direction and would help to streamline not only the stamp duty assessments but also the entire system of property taxation in the country.

5. Concluding Remarks

PT in India requires urgent reform. The plinth area approach has considerable merit but it must be tailored to meet the objectives of transparency, equity and administrative ease. Considering the tests of reasonableness insisted upon by the courts, it is doubtful if the scheme like the one introduced in Patna or Ahmedabad will be able to stand up to scrutiny in the future especially when revisions are undertaken. The recent judgement of the SC upholding the Patna scheme should be taken only as a reprieve. For an enduring solution, some rethinking is called for and consideration should be given to replacing the ARV with CV as the base with standards of land values and construction cost forming the basis of valuation. Administration of the tax also needs to be thoroughly overhauled and modernized if the new system is to yield tangible results.

Endnotes

1. State of Bihar and others v. S.K.P. Sinha & others, AIR 1995 SC 885.
2. Vide, for example, Section 114 of the Delhi Municipal Corporation Act, 1947.
3. Corporation of Calcutta v. Padma Devi (1962) 3 SCR 49.
4. Corporation of Calcutta v. Life Insurance Corporation of India (1970) 2 SCC 44; Guntur Municipal Council v. Guntur Ratepayers' Association (1970) 2 SCC 803; and Dewan Daulat Rai Kapoor v. NDMC and others (1980) 1 SCC 685.
5. Dr Balbir Singh and others v. Municipal Corporation of Delhi AIR 1985 SCO 339.
6. 1977 (1) SCR 1017.
7. Dewan Daulat Rai Kapoor v. NDMC (1980)(2) SCR 607.
8. S.K. Jituri v. Corporation of Belgaum (1994) 5 SCC 572.
9. Asstt. General Manager, Central Bank v. Commissioner, Ahmedabad Corporation (1995) 4 SCC 696.
10. Vide endnote 1.
11. Vide for example, Bhuvaneshwari v. State of Mysore (AIR 1965 MYS 183).
12. Vide endnote 1.
13. Clause 3(1)(a) of the Municipal Corporation of Delhi (Determination of Rateable Value) By-laws 1994.
14. Delhi Urban House Owners' Welfare Association & another v. Union of India and others (Civil Writ Petition No. 5102 of 1994) decided on 10 September 1995.
15. Sripuram Welfare Association v. Government of Andhra Pradesh and others (Writ Petition No. 15309 of 1994 before the A.P. High Court decided on 29 December 1994.
16. For illustration of how the formula is applied, see "Property Tax System in Ahmedabad" in papers prepared for Policy seminar on *Property Tax Innovation in India*, organised by NIUA, NIPFP, Community Consulting International, and USAID, New Delhi, August 1996.
17. The scheme proposed by Kapoor and Ghosh talks of "unit area annual value" without clearly mentioning whether annual value refers to annual rental value or capital value and seems to use the two interchangeably.

18. For a more elaborate discussion of the recommendations of the Layfield Committee and their critique, see NIPFP (1981).
19. Business Standard, 5 July 1997.
20. This would be perfectly valid under the law, vide the judgement of the SC in AGM Central Bank v. Ahmedabad Corporation.
21. Non-domestic properties are however subject to a tax levied at a nationally uniform rate with proceeds distributed among local authorities on the basis of an equal amount per adult head.
22. The bands and the percentages of the mean (Band D) prescribed for England is as follows:

Band	Range of property value (% of mean)	Range of property value (Pounds)	Tax bills as a ratio of the bill for a property in Band (D)
Band A	50	under 40000	0.67
Band B	50-65	40000-52000	0.78
Band C	65-85	52000-68000	0.89
Band D	85-110	68000-88000	1.00
Band E	110-150	88000-120000	1.22
Band F	150-200	120000-160000	1.44
Band G	200-400	160000-320000	1.67
Band H	over 400	over 320000	2.0

Source. King (1993)

References

- Bagchi Amaresh. 1991. Property Tax Reform: The Case of Delhi. Paper presented at workshop on Property Tax Reform in India. Hyderabad. January 1991.
- Bahl, R.W. and J.F. Linn. 1992. *Urban Public Finance in Developing Countries*. Oxford UK: The World Bank.
- Banerjee Tapan K. 1994. *Local Finances in U.K. : Beginning of a New Fiscal Regime* (Unpublished).
- Datta Abhijit (ed.) 1983. *Property Taxation in India*. New Delhi: Indian Institute of Public Administration.
- Delhi Administration. 1990. Report of the Expert Sub-Committee of the High-Powered Committee on Property Taxation in the Union Territory of Delhi (Mimeo).
- Foster C D., Jackman R. and Perlman M. 1980. *Local Government Finance in a Unitary State*. London: George Allen & Unwin.
- Gibson, John. 1993. *British Local Government Finance under the Conservatives*. UK: Gibson and Batley.
- Gibson John and Batley R. (eds.) 1993. *Financing European Local Governments*. UK: Frank Cass.
- Jha Gangadhar. 1980. Area Basis of Valuation for Property Tax: An Evaluation. *Nagarlok*. July-September. XII (3).
- Kapoor R.M. 1977. Finances of Calcutta Corporation: Problems and Prospects. *Nagarlok*. January-March. IX (1).
- Kapoor R.M. and Ghosh P.K. 1990. *Composite Area Linked System for Property Tax in India & A Specimen Draft Bill*. Calcutta: Times Research Foundation.
- King David. 1993. Local Taxation—Lessons from Britain in Sandford Cedric ed. *Successful Tax Reform: Lessons from an analysis of tax reform in six countries: Key Issues in Tax Reform*. Bath UK: Fiscal Publications.
- Linn J.F. 1976. *Urban Public Finance in Developing Countries: A Case Study of Jakarta*. Indonesia. Washington DC: World Bank.
- Mohan Rakesh. 1983. Indian Thinking on Property Tax Reform in Datta Abhijit ed. *Property Taxation in India*. New Delhi: Indian Institute of Public Administration.

- NIPFP. 1981. Property Tax Reform in West Bengal. Report of a team led by Amaresh Bagchi published as Supplementary Volume II to the Report of the West Bengal Municipal Finance Commission. New Delhi: National Institute of Public Finance and Policy.
- ORG. 1979. Property Tax System in Madras Urban Agglomeration. New Delhi: Operation Research Group.
- Ramakrishna G V. 1980. Municipal Property Tax: A New Approach. *Nagarlok*. July-September. XII (3).
- Santigosa Angels. 1993. *The Finance of Spanish Local Governments and its Recent Reform*, UK: Gibson and Batley.
- Singh, S.K. 1996. New Property Tax Rules in Patna. Paper presented at Policy seminar on Property Tax Innovations in India. New Delhi: National Institute of Urban Affairs; National Institute of Public Finance and Policy; Community Consulting International; and USAID. August 1996.
- Watt Peter. 1996. *Local Government: Principles and Practices*. London: Witherby & Company.