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WHAT PROPERTY TAXES CAN DO..... 1

What property taxes can do

Taxation can be a powerful tool for fighting inequality

Even though the finance minister has indicated property tax in the current National Budget, a comprehensive and workable framework or approach is yet to be in place.

A policy paper on the feasibility and desirability for the re-introduction of property tax was prepared by Economic Research Group (ERG) for National Board of Revenue (NBR) in 2012, with an intent to provide input to the preparation of National Budget for 2012-13.

Unfortunately, this initiative has not yet been explicitly translated into tax policy and budgetary allocations. While this remains to be seen, the introduction of property tax has also become a public agenda in terms of income inequality reproduced and maintained by existing tax systems.

A closer look at the existing revenue landscape indicates that the revenue generated from direct tax (35.17%) is almost half of the indirect tax (64.73%) and more importantly, about 1% less than VAT (36.07%), which is paid by common people.

That means common people, particularly the poor, are bearing the major burden of the tax. This situation eventually increases the real income gap between rich and poor, resulting in inequality. The inequality as such is sustained due to the existing generation of taxation that heavily depends on VAT, and puts less effort in raising revenue from other taxes.

Therefore, it is high time to make a shift towards a new generation of taxation if we want to reduce inequality caused by taxation. The new generation of taxation is the reversal of the current state of taxation, ie progressive reduction of dependency on VAT, and increased revenue-raising from property tax.

Indeed, the primacy of property tax for moving towards a new generation of taxation bears practical value in the context of rising real estate growth, growing business and investment initiatives, followed by the growth of multiple commercial establishments. The comparative advantage of imposing property tax lies with the fact that it is visible, and thus more enforceable than other taxes.

While property tax has great potential for creating a new stream of revenue generation, implementation of it is far more challenging broadly for three reasons -- methodological, power relations, and weak enforcement mechanism.

As far as methodological issues are concerned, one of the major challenges is a lack of authentic information. The value of a property, particularly under current market prices, on which the tax assessment should be made, largely remains unknown. Besides, property values vary widely across and within an area.

As a result, the assessment is more likely to be biased.

Another factor affecting valuation of a particular property is heterogeneity and individual properties characterized by location, size, number of rooms, occupancy, age etc. Subjective criteria in defining boundaries of tax jurisdictions is also more likely to be reflected in the estimation of the land value, which may eventually lead towards incorrect land value.

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Above all, estimation becomes further difficult, because information on rental value is not available in public domains. This situation is further aggravated by undue political pressure by interest groups, making records on financial wealth of individual tax-payers customary, rather than mandatory. Finally, it is difficult to enforce because the method of revenue collection from property tax is expensive.

In order to offset the challenge of the expensive method of collection, property tax could be decentralized, and a local government could be the source of property tax collection. Once property tax is considered as local tax, the scope for benefiting people through distribution of revenue in the form of local level public services will be enhanced.

Considering the divergent factors affecting property valuation, different tax bases could be determined. Thus, market value could be considered as the tax base, where there is high degree of ownership and availability of considerable evidence for open market transactions. Alternatively, rental value could be adopted when these conditions are not satisfied.

Apart from these, the establishment of strict regulatory mechanisms is required to make property taxes enforceable. Digitization of records on different properties could also facilitate this process. Last but not least, a comprehensive policy framework is required to make property taxes work.

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