Property Taxes in the Punjab, Pakistan

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Abbreviations

CDG	City District Government (Council + Nazim + City District Administration)
E&T	Excise and Tax Department of Punjab
GoPunjab	Government of Punjab Province
LDA	Lahore Development Authority
LGs	Local governments (CDG, TLG, ULG)
LGO	Local Government Ordinance (2001)
LRA	Land Revenue Act 1967
O&M	Operation and Maintenance
Rs.	Pakistan Rupees
TMA	Tehsil or Town Municipal Administration
TLG	Teshsil/Town Local Government (Council + Nazim +TMA)
UC	Union Council
ULG	Union Local Government (UC + Nazim + Union administration)
UIPT	Urban Immovable Property Tax
WASA	Water and Sanitation Authority

Executive Summary

Pakistan has a relatively long experience with, and a robust framework for taxing real properties, and is among over 130 countries, including 49 of the Commonwealth of Nations countries, where some form of property tax is collected. Since it was introduced in 1958, repeated efforts have been made to enhance the framework of property taxation in the Punjab—the Urban Immovable Property Tax (UIPT). Yet, both the yield of property tax and its importance among local revenues have remained very low by international comparisons. The major impediments are: ambiguous fiscal policy regarding the role of property tax, narrow tax bases, broad and distorting exemptions and reductions, ill-calibrated annual rental value of some property categories, ineffective tax administration, low collection rates, and unreliable collection records. Recent generous exemptions also serve to further erode property tax revenues in the Punjab Province.

This note provides an overview of the current property taxation system in the Punjab Province based on the premise that the property tax: (i) is essentially a fiscal tool; (ii) is not an instrument of social redistribution; (iii) system should be kept simple; and (iv) is a technical instrument with strong financial, institutional, and political connotations. We first address tax policy and tax administration issues and then draw conclusions outlining possible actions for enhancing the taxation system and increasing property tax revenues in the short and medium terms. The main areas of potential changes are highlighted next.

Property taxes are levied on a banded annual rental value (ARV) basis, calculated from valuation tables issued by the Excise and Tax Department. The ARV tables provide a reasonable ground for defining the tax base, yet they need to be revised and harmonized, as well as aligned with each other in order to improve equity and fairness of the UIPT. For instance, impact analysis would help in calibrating ARV tables and harmonizing unit values across various residential, commercial and industrial properties.

Simplifying ARV tables would present a major improvement in property tax administration. Measures could include valuing all commercial and industrial properties at rental values, and gradually narrowing the gap between ARV of self-occupied and rented residential properties down, as appropriate, to the 1:2 ratio of differentiation enacted in 1963.

Reductions and exemptions distort and, in fact, overwrite the ARV tables, while aiming to correct them. Of all of the changes, the exemption of all residential properties up to 5 Marlas (125 sq yards) in the plot area provides the most cause for concern, since it significantly reduces the property tax base. If the aim is to support poor families, a proper value exemption can fulfill that function, but 5 Marlas is too large an area to exclude, especially when compared to international experience. It is very likely that this exemption includes numerous high value properties (with over 400 sq yard floor space), and is conservatively estimated to reduce the tax yield by 25%.

The current property tax collection information base is unreliable, and the collection rate is currently very low around 55% of billings. Town Municipal Administrations (TMAs) are neither aware of, nor motivated to increase the low UIPT collection rate. It is of crucial

importance to encourage local governments—both City District Government (CDG) and TMAs—to become real managers of the UIPT and actively participate in the enhancement of local property taxation. They would then collect much more revenues in an equitable, stable, and efficient taxation system.

To date, the property tax is essentially shared revenue, although many TMAs have received a negligible share or nothing in the last few years. Accounting for property tax proceeds as local own source revenues, which are transferred strictly back to the source jurisdictions, would be an easy and immediate improvement of local revenues, and thus a vital instrument for enhancing the motivation of local governments in fulfilling their tax policy and administration functions.

By transforming the UIPT into a real local tax, CDGs could immediately receive the share currently retained by the Province. After careful revision of local revenue and expenditure assignments, the share of CDGs and TMAs can be further corrected in the medium term.

Only well informed local governments can make proper decisions, and exercise sound tax management and administration. Thus, developing a reliable, consistent and consolidated fiscal database at both the CDG and TMA levels that reflect up-to-date ARVs, exemptions, and payment records for each property and by taxpayer would be a major improvement for enhancing the property taxation system.

GoPunjab may wish to strengthen the UIPT tax administration with the aim of enabling greater involvement of local governments in tax policy and administration, with minor changes of the present legislative framework. The role of CDGs can be revised, and with sufficient capacity building, both CDGs and TMAs can jointly exercise key tax policy and administration functions in both the short and medium term.

Introduction

1. Rapid urbanization and devolution of service functions from central governments increasingly place pressure on local governments to boost revenues in order to expand access and improve the quality of local services. Although there is no dominant form or ideal composition of central and local taxes, or shared and locally collected revenues, there is a general tendency for governments in developed countries to rely more and more on local tax revenues. Good local services require a stable, predictable, buoyant, and equitable revenue stream with relatively neutral impact on private economic decisions (Bell 2003). Since the local property tax scores well on these criteria, it is not surprising that it is collected in the majority of countries, whether industrial or developing nations.

2. Compared to most developing and transition economies, Pakistan has a relatively long experience in taxing real properties. It is among over 130 countries, including 49 of the 55 Commonwealth of Nations countries, where some form of property tax is collected (Franzsen 2005). Since its introduction in 1958, repeated efforts have been made to enhance the framework of property taxation in Punjab. Yet, both the yield of property tax and its importance among local revenues have remained very low by international standards; and recent measures (e.g. generous exemptions) may further erode property tax revenues.

3. This note summarizes the key attributes of the present property taxation system of the Punjab Province and proposes some solutions for improving the property tax system. Our analysis is based on the following premises: First, the property tax is essentially a fiscal tool. Second, it is not an instrument of social redistribution. Third, the property tax system should be kept simple. Fourth, the property tax is not merely a technical instrument, but it is a substantial revenue factor with strong financial, institutional, and political connotations (Paugam 1999). Following an analysis of the legal, institutional, and organizational framework of the tax policy and tax administration system, we draw conclusions and suggest recommendations for possible actions to be taken at both the Provincial and Local Government levels to enhance the taxation system and increase property tax revenues in the short and medium term.

4. Discussions of local government in the Punjab often leads to confusion, as it is not always clear which of the three tiers are being referenced. The LGO 2001 clearly defines three layers of local government: (i) City District Government (CDG) that consists of the Zila Council and the District Administration headed by the Zila Nazim; (ii) Tehshil or Town Local Government (TLG) that consists of the Tehshil/Town Council, the Tehshil/Town Administration (TMA) and the Nazim; and (iii) Union Local Government that consists of the Union Council (UC), the Union Administration and the Union Nazim. These detailed definitions are often ignored, and instead the local government tiers are referred to more simply by the following three tiers: City District Government (CDG), Tehshil/Town Municipal Administration (TMA), and Union Council (UC). In this note we also apply the latter terminology as it is commonly used in the local government literature in Pakistan. It is worth mentioning that local councils are entitled to local tax policy decision (e.g. setting rates), while the local administrations are assumed to fulfill most of the local tax administration functions.

Property Tax and Revenue Base

5. The present Punjab legislative and institutional framework reflects both good and bad practices, and combines conflicting fiscal and social policy objectives. However, the net effect is to constrain the performance of the property tax as a buoyant source. This calls for an urgent need for a political consensus on a key policy issue if the property tax is expected to generate substantial local revenue. Table 1 below illustrates that no major legal changes are required for enhancing the property tax system, but rather implementing of current rules would suffice.

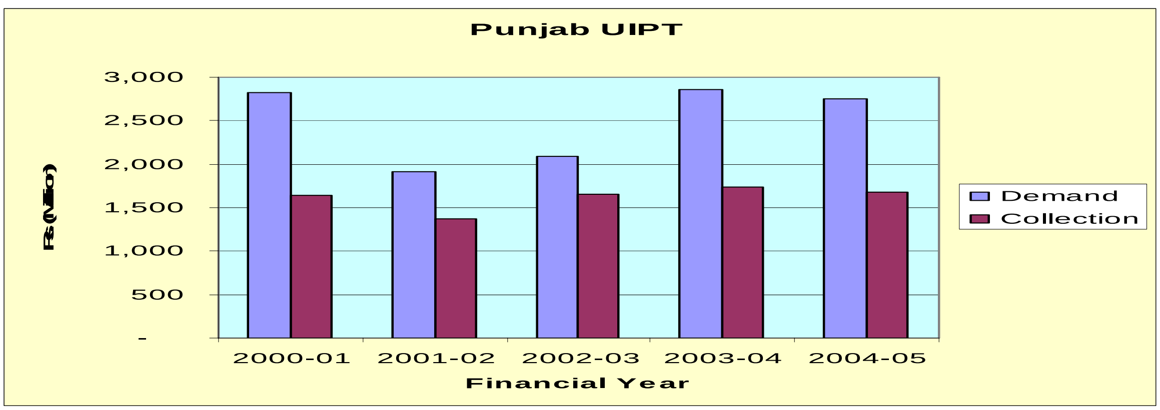
Table 1: Property Tax Framework—Present and Future

Function	**Fulfilled by Law**	**Fulfilled Actually**	**Proposed Fulfillment**	**Comments**
Tax Policy issues				
Overall tax policy and regulation	Government	Gov/E&T	Gov/E&T	
Defining policy on tax base	Government	Gov/E&T	Gov/E&T	
Maintaining ARV tables	Government	Gov/E&T	Gov/E&T provincial CDG requests inflation adjustment	
Tax Rate National Local	Government TMA	Gov/E&T Na.	Gov/E&T CDG with TMAs	 Legal change needed
Exemption policy	Government	Gov/E&T	Gov/E&T	
Local exemptions under provincial rules	Local Gov.	Na.	CDG	
Sharing of tax proceeds	Government 5% collection fee 15% province 85% TMA	Finance Dep. + E&T 5% collection 15% province 58 % Utilities, 22% TMA	CDG by law 5% collection 70% CDG 30% TMA	No intercept on UIPT proceeds; CDG TMA share need calibration
Tax Administration Issues				
Valuation	Assessing Authority	E&T	CDG with E&T guidance, oversight, remedies	Needs full devolution of E&T staff
Billing	District Collector	E&T	CDG with District Collector	Collector could be the CDG Revenue Officer
Collection	District Collector	E&T	CDG with District Collector under E&T oversight	
Enforcement	District Collector & Commissioner	E&T	District Collector & Commissioner	

6. Property tax policy entails determining local property tax functions within the framework of the local revenue and overall taxation systems, and defining the tax base and

tax rate accordingly. In theory, governments can estimate desired revenue yields from property taxes to cover their local service costs, and set the appropriate tax rate against the known tax base to achieve their revenue targets. In practice, however, the historic tax base and tax rate limit the latitude that governments have to introduce significant changes in either the tax base or rate (Youngman 1994).

7. While the property tax accounts for at least half—although often significantly more—of total local revenues in many countries, it represents less than 10% of TMA revenues in the Punjab. To carry this comparison further, property taxes represent an average of 1.42 % of GDP in industrialized countries, 0.42% in twenty developing countries, and 0.54% in transitional countries; yet, they account for a fairly insignificant share of GDP, estimated at 0.09%, in the Punjab (Paugam 1999, Bahl 2005, Kaiser 2005). The Punjab Urban Immovable Property Tax (UIPT) revenue is not only a small portion of local government revenues, but has also hardly grown in the last five years (see chart below) despite remarkable increases in the value of tax bills issued. The tax revenue even fell slightly between the 2003/04 and the 2004/05 fiscal years, which suggests that the present tax collection is inefficient.



Source: Excise & Taxation Department, Punjab Province

8. The property tax in the Punjab is part of the broad Provincial fiscal revenue system, although it is not only a shared tax, but primarily a Provincial transfer and revenue redistribution instrument. Due to various fiscal redistribution rules, the UIPT yield is not returned proportionately back to the source jurisdictions. By law the TMAs are entitled to "collect" the UIPT. In practice, the Excise and Taxation (E&T) Department collects the tax and the Finance Department redistributes the UIPT proceeds to LGs. Many TMAs receive only a small share of the UIPT among government entities in some cases. For instance, the UIPT collected in Lahore provides 5% for collection charges to E&T, 15% to provincial revenue, and of the remainder 50% to WASA, 25% to LDA, and 25% to TMAs. The Province also intercepts UIPT proceeds, and as a result for many TMAs no UIPT revenue was effectively transferred during the last 2-3 years.

9. Three simple measures could make the UIPT real own-source revenue. First, the Province could forgo its revenue share and let it be distributed to TMAs and CDGs. Second, the Province could refrain from intercepting the UIPT, and instead intercept regular transfers.

Third, the local governments should account as own-source revenue all UIPT proceeds provided presently for them or any of their local entities. For instance, CDG Lahore could account UIPT proceeds presently channeled directly to WASA and LDA as CDG own revenue, and then account these as subsidy expenses to WASA and LDA respectively.

Distortions in the Property Tax Base

10. **The current tax base.** The Punjab property tax system is largely comparable to international practices, albeit that challenges remain. The key attributes of the property tax in nutshell are as follows: (i) the tax base considers the combined annual rental value of land and building; (ii) the tax base assessed in a banded system based on provincially set Annual Rental Value (ARV) tables that define nearly 400 floor-based unit values for residential, commercial, and industrial property categories (see Annex table 1, 2, and 3); (iii) all kinds of properties are taxable (except exempted ones), since rural/urban distinctions no longer exist within the borders of TMAs/CDGs; (iv) there are three basic deductions (for furniture, repair, and land tax paid), but numerous other reductions also apply; (v) there is a long list of tax exemptions; and (vi) there is a fair set of remedies, and appeals against valuation rolls are possible.

11. ***Annual Rental Value.*** The UIPT Act of 1958 states that the tax is levied annually, and based on the annual rental value (ARV) of the property. ARV is defined as the gross annual rent at which such land or building *might be expected to be let* from year to year, less deductions for repair and maintenance. Thus, the initial regulation is in full harmony with international standards and has the advantage of being general, uniform, and inclusive (Bell 2003). The initial rules can be interpreted as stipulating that the tax is levied on all real properties and that rental value is based on the best alternative use ("expected to be let") not on actual rental fees. However, with the introduction of various amendments (see Box 1 below), which were presumably motivated by practical, policy and political reasons, the present property tax framework is no longer consistent with good practice, nor its intent of the initial UIPT Act 1958.

12. Effective January 2002, gross annual rental value (GARV) has been calculated from "valuation tables" prepared by the Excise and Taxation (E&T) Department based on house-to-house rental value assessment (see evolution milestones in Box 1). For tax base assessment purposes, four major factors are taken into account: use, quality, location, and size. GARV is assessed for residential, commercial-service (trade, hotel, catering etc.), and industrial properties (Annex tables 1, 2 and 3). The properties are divided into 7 clusters (Class A to G, where A represents the maximum rent). Each class is further subdivided into 'main road' (over 30ft wide) and 'off-road', and into owners-occupied and rental categories. Finally, ARV unit values are provided for 11 land-size and 10 building-size categories. The assessment rolls now reflect band values with respect to floor area not the actual rental value of the properties – similar to the English banded council tax (Tassonyi 2004).

Box 1: Milestones of tax base setting and calculation

1958 UIPT Act 1958: Initial rules
1963 UIPT amendment through Punjab Finance Act (PFA): ARV owner occupied = ½ ARV rental properties
1966/67 UIPT amendment: rented property ARV be reappraised every five years, owner occupied ARV frozen
1972 PFA: owner occupied GARV be increased by 10% (20% for properties over Rs. 20,000 value) every five years on the 1966 basis
1998 PFA: GARV based on Land Value estimated every three years based on market value for levying fee for registration of properties under the Stamp and Registration Act. Despite gradual increase the ARV of owners' occupied properties left far below the ARV of rented properties; a 15-fold difference occurred at end -2001.
July 2000-December 2001: Excise and Taxation Department initiated UIPT demand GARV based on market value of land and improvements [GARV= X% of (cost of land + cost of construction)]; this was ruled illegal by the provincial High Court and Supreme Court end 2001
2002 January Excise and Tax Department introduced Valuation Tables based on annual rental value and reduced the difference between rented and owners' occupied properties from 1:15 to 1:10 ratio but increased exemptions.

Source: *Complied from Sydat Hyder Morshed Associates (2005)*

13. Under PLGO 2001, all areas in the TMAs have been declared as rating areas; that is, the UIPT can be levied on all properties within the TMA jurisdictions as the previous division of rural and urban properties has been abolished. Thus, TMAs can now levy the UIPT on all areas including those which were defined as non-rating areas under the old rules. This represents a significant improvement in the definition of the tax base. However, TMAs need to get approval of the provincial government through the Excise & Taxation department to include the previously unregistered properties without which, the rate on these properties remains zero.

14. With the introduction of the ARV tables, the basic inconsistency of the Punjab property tax system was reconfirmed. For instance, the rental value is estimated and recorded based on the present use, which is not only in conflict with the basic tenet of the banded system, including section 5 of the UIPT Act, but is also technically inconsistent and creates a confusing tax base record. In most countries where the ARV is the tax base, preferences and subsidies to owners (or special social groups) are provided with a lower tax-rate or exemption, rather than different ARV (Youngman 1994). The UIPT Act 1963 followed this principle.

15. The introduction of a banded system that takes into account location, quality and size allows Punjab, and a growing number of developing countries that have adopted this approach, to avoid having to determine a market value for each unit in the absence of a well established real estate market. Banding is regarded as an adequate means for arriving at a more accurate and uniform assessment of values in countries where the rental and real estate markets are shallow, and land cadastres are unreliable or non-existent. However, shallow markets are not preconditions for use of a banded system. For example, the UK has a well-functioning banded system, even though it has deep real estate, rental, and capital markets. The benefits for many developing countries, though, are due to the administrative simplicity and political acceptance of a banded system.

16. Unfortunately, in the Punjab the benefits of the banded tax system are compromised by the numerous distortions to the tax base introduced through rent control, reductions and exemptions. An effective banded system is characterized by a broad tax base and low tax rate (Bahl 2002). It also uses a flat valuation in each property band, and is not overburdened with social, economic, or administrative objectives, whose effects may offset each other, while contradicting the core goals of simplicity and fiscal revenue collection (Paugam 1999).

17. ***Residential, commercial, and industrial properties.*** Taxing residential, commercial, and industrial properties with separate rates is a common policy around the world. The ARV, however, should reflect real differences in rental fees, i.e. the rental value a willing and informed renter would pay. If the Punjab ARV tables were really based on actual rental values from house-to-house surveying of properties, one would expect much less difference between some commercial and residential, or commercial and industrial property classes. The present ARV tables suggest that even the lowest category of commercial land is valued at a higher amount than the best residential properties (Annex Table 1). Thus conflicting tax and social policy objectives distort the present Punjab ARV tables.

18. The industrial properties are valued with residential ARV. This is a highly questionable practice because with the 3-6 fold difference between industrial and commercial ARV commercial services are highly disadvantaged. Indeed there is a need to retain sufficient balance between categories of taxpayers that contribute to financing local municipal services used by the enterprises in their line of business and to provide their workforce with adequate living conditions to maintain their health.

19. The present arrangement clearly does not work in favor of commerce, and there are anecdotal stories of the hotels in Lahore petitioning to be considered part of the tourist industry in order to pay less tax. Another example is that a medium sized printing press in Gulberg, Lahore, with 5,000 sq yard land and 24,600 sq. ft covered area has a gross ARV of Rs.110,000. A medium size department store in the same zone with only 500 sq yard land and 24,600 covered area has a gross ARV of Rs.457,000 (Annex table 4). Thus the printing factory needs to pay about Rs.19,800 (US$330) a year, while the department store pays about Rs.82,200 (US$1370). This illustrates the extent to which annual rental values might be impacted by the policy.

20. Many countries have classified industrial property as a separate category, due to its special features. One such country is the UK, which applies a fixed national rate to industrial property, the ARV, which is assessed as follows: (i) where a rental market exists, these rates are used on an area basis. Since the objective is to assess the industrial building, the industrial plant is excluded except when the plant is needed to run the building, such as air conditioning; (ii) where the plant is specialized (for example, an oil refinery) and there is no rental information available, an estimate of the rebuilding cost is used which is de-capitalized according to a nationally set factor (presently 5%). Only the cost of the structural steelwork is included, not the industrial plant; (iii) it is assumed that the rental value is based on an annual tenancy assumption; and (iv) empty premises are fully exempt (unlike vacant commercial property which gets only a 50% exemption).

21. The ARV tables provide a reasonable ground for defining the tax base; yet they could be revised, harmonized, and aligned with each other in order to improve equity and fairness in the UIPT. It is a matter of urgency to conduct ratio studies and sample valuations in order to not only calibrate ARV unit values across various commercial and industrial properties, but also to make the three different valuation base explicit and adopt separate ARV tables for industrial properties.

22. ***Rented versus self-occupied properties.*** There are a number of anomalies within Punjab's property tax arrangements, but one of the most noticeable is the significant subsidy given to owner-occupiers of properties. Section 3 of the UIPT Act 1963 stated that owner-occupiers need only pay tax on one half of the annual rental value. Over time, realizing the likely political impact of allowing such property to be fully revalued, successive Governments have restrained the revaluation with the effect that, rather than keeping the initial ratio of 1:2 between owner-occupied and rental units, the difference in ARV had risen to about 1:15. With the introduction of the ARV tables, this ratio has dropped to 1:10, which is a big achievement of the E&T Department.

23. As a result of this bias, it is estimated that while about 30-35 percent of properties are rented and about 65-70 percent are owner-occupied, the revenue ratio is in reverse order. Over 80 percent of the revenue comes from the rented properties and less than 20 percent of the revenue comes from the self occupied properties. Bringing all properties on a par with today's values for rented properties would more than quadruple the total UIPT demand, partly because of the increased ARV, but also because it would eliminate or substantially reduce the incentive for not reporting or under-reporting rental value.

24. The ratio between the ARV of self-occupied and rented properties is clearly a tax policy issue/decision since the ARV of a self occupied property conceptually cannot be directly observed from the market. Rather, it is estimated either as a ratio of a rented property (50% in many countries) or from the capital value of the properties (where ARV often amounts to about 8 to 10 percent of the capital value). To the extent that property tax is thought to be collected to finance local services that cannot be charged directly, there is no compelling argument that supports any distinction between self-occupied and rented properties. For instance owners and users pay half and half of property tax in Holland, while only residential properties are taxed in Sweden (Youngman 1994). Gujarat India, which faces the same problem, is moving toward reducing the gap and getting back to a 1:2 ratio (Weist 2005).

25. Closing the gap between self-occupied and rented residential properties remains a major challenge in the Punjab. The first big step was made in 2002, but as revaluation only occurs once every five years this will be a long process. One option for speeding up this process would be to introduce annual indexed adjustments of ARV in the intervening period. The advantage of such a system would be that increases in property tax payments for owner-occupiers could then be phased, with smaller increases each year rather than one major increase every five years. This would have the added advantage of retaining the real value of tax yields between revaluations rather than having it eroded by inflation as is presently the case.

26. There is a major equity issue to be addressed in calibrating rented and owners-occupied residential ARV. There are strong arguments that the owners of high-value properties benefit more from local services for various reasons (e.g. own more cars and use more roads, produce more garbage, demand better street lighting) From this perspective, it is rather in-equitable to allow owners of an “A main road” category to pay less UIPT than the owners of the rented properties in a “G off-road” zone—the lowest category in a city (see Annex Table 1: ARV for residential properties).

27. The distinction of tax base of the owner-occupied and rented *commercial and industrial properties* is even more problematic for four reasons: first, the difference distorts competitiveness; second, using self-owned properties for commercial or industrial purposes can be considered as a virtual rental relation; third, there is a great deal of uncertainty in capturing rentals in many commercial/industrial businesses; fourth, property tax subsidies granted as general rule of the province have proven to be ineffective in boosting local businesses and job-creation (Paugam 1999). Furthermore, property tax paid is deductible from other taxes (e.g. personal income tax) in countries which tax rented properties at a higher rate. Nonetheless, this tax deduction constitutes a redistribution of tax revenues from central to local levels.

28. ***Rent control*** serves to substantially erode the tax base and distorts the ARV tables. The Punjab Urban Rent restriction Ordinance (1959) allows no rent increase for residential properties for a 3 year period, unless there are some additions or improvement. For commercial/industrial properties the Ordinance allows automatic rent increase of 25% every 3 years. But, owners can charge only half of the tax increase and only with the Controller’s approval. Evicted tenants have a right to continue residing in the new or renovated building with a “fair” rental fee determined by the Controller. Under these rules even very precise surveys would fail to capture the rental value for a unit “expected to be let” as the UIPT Law suggests. Special weighted sampling could help in overcoming these severe impediments and fundamental contradiction of the present ARV tables.

29. Rent control has become a major impediment for the rental value assessment. The E&T Department’s attempt to overcome this impediment by introducing a capital value based taxation system was ruled illegal by both the High and Supreme Courts of Pakistan. Alternative approaches are needed to reduce the distortionary effects of rent control. Weighted sampling could be one instrument. Under such a system, recently rented properties would receive the highest weight, with weights reducing progressively depending on the start of the existing contract (more than three years). This would still be consistent with section 5 of the UIPT Act.

30. ***Reductions.*** The general provisions of the UIPT Act are in harmony with international best practices. Namely reductions are granted by age, for furnishing/repair, and land tax paid. This is fair and consistent with the fact that the ARV tables capture *quality, location, and size,* but not age and repair when estimating the rental value (section 5 of the UIPT Act). The UIPT Act provides for a 10% reduction for annual repair and an additional 10 % for buildings aged 20 - 30 years. If the building is more than 30 years old an allowance

of 15% is given. It is important to note that the property tax demand is based on *net ARV*, where:

Net ARV = GARV– allowance for annual repairs – allowance for building age – land tax paid.

31. An exhaustive list of further reductions and additions has emerged in Punjab over time, and particularly in conjunction with the introduction of the new ARV tables—possibly as a result of a bargaining process (see Box 2 below). Some of the major reductions are also used in other countries, such as a 50% reduction for seasonal, cultural or education properties. Other reductions/additions to the tables actually rewrite them, or move properties from commercial to residential valuation or to mixed valuation, which applies to one building (e.g. plazas, hotels, hospitals). In addition, among the list of reductions are the provisions for valuating Industrial properties. This valuation creates a big inconsistency in the UIPT. It is understandable that the ARV of special type of properties should be different from the general residential or commercial properties, but a banded ARV system should not be overburdened and distorted with mounting reductions.

32. The UIPT Act does not include a list of reductions; rather the three basic reductions are listed in section 5 under "ascertainment of annual value"; other reductions are in separate ordinances. What is more concerning is, that the demand notes (Form PT 10 – see Annex table 5) do not indicate reductions or exemptions. The form is limited to indicating the ARV factors, and the two basic reductions, but neither owner-specific reductions or exemptions nor the Net ARV are listed or announced in the demand note, hence these information are presumably not well communicated with the property owners. The small box for "Tax Calculation" allows inclusion of information about reductions or exemptions, but this is obviously a substandard approach that provides for a not fully reliable tax treatment of customers. Furthermore, the demand note suggest that it is not assured that property owners whether exempted temporary or permanently receive a demand note certifying that they have no tax liability.

33. While the system clearly aims to capture factors that influence rental value, the effectiveness of the system depends largely on the calibration of the unit values across the 392 value categories. The mounting number of reductions and exemptions indicates that the calibration of the ARV tables is not optimal. The present Punjab system is admittedly and unavoidably burdened by the legacy of the previous property taxation structure. As a result, it has an extremely narrow tax base, includes redundant rules, and is overburdened with conflicting social and economic objectives and inherited distortions in the historic property tax scales.

Box 2: Reductions and Additions respective to the ARV valuation tables

1. Plazas and rented- out multistory buildings:
    - Reduction of 10% for each floor above and below ground floor; inter-floor subject to a maximum of 50% of the rate specified in valuation table.
2. Seasonal use of properties like cotton-ginning factories rice husking mills, oil mills, ice factories etc
    - Reduction of 50% of the rate specified in the valuation table.
3. Buildings and lands used as office, educational institutions etc.
    - Addition of 50% in the residential rates (self or rented as the case may be) specified in the valuation table.
4. Hotels: buildings and lands used for hotels, ARV shall be assessed as per the following:
    - ARV of land area under commercial use excluding parking places shall be calculated on the basis of self-commercial rates.
    - ARV of covered area of such buildings other than that of lodging units, lobbies dinning halls, kitchens other than the banquet hall, business halls etc. shall be assessed on the basis of self commercial rates prescribed in the valuation table.
    - ARV of covered area let out to different organizations will be assed on the basis of commercial rates prescribed in the valuation table.
    - If portions of above hotel units let out, as lodging units shall be assessed on the basis of existing formula based upon rack rates giving allowance on account of vacancy/ service change and machinery as the case may be according to the existing procedure.
5. Hospitals and marriage halls, cinemas, petrol pumps etc.
    - ARV calculated on commercial rates self or rented as the case may be specified in valuation table. At the time of calculation of land area and covered area, the doctors' rooms, patients' rooms, wards, operation theatres, waiting rooms/bridal rooms, make-up rooms etc shall be accounted for.
6. Industrial units: Residential rates (self or rented as the case may be) prescribed in the valuation table with following conditions:
    - Up to 1 acre (1 hectare = 2.5 acres) residential rate of ARV table
    - Next 4 acre - reduction of 20% in the above rate
    - Exceeding 5 acres - Further reduction of 20% in the above rates.
7. Agricultural land: As per existing procedure of fixed rates.
8. Godowns/ workshops with tin shed: Reduction of 50% in commercial rate self or rented as the case may be as specified in the Valuation Table.

Source: Punjab Update on Municipal Finances (August 2005); World Bank Study by the Sidat Hyder Morshed Associates (Pvt) Ltd. Management Consultant

34. ***Exemptions*** on a few properties are common in many taxation systems; Punjab has a number of them offering 10 sets of exemptions in the present UIPT. Exemptions are granted by *ownership* (for public properties), by *use* (public parks, playgrounds, libraries, sites of public worship), by *value*, by *size* of residential properties, and by specific merits. Although several of these exemptions can be justified and are commonly practiced elsewhere, the list of exemptions is redundant. Some exemptions are questionable from an equity, fairness, and efficiency perspective (see Box 3). Overall, the generous exemptions have greatly undermined the UIPT integrity, consistency, transparency, and revenue capacity.

Box 3: Exemptions for UIPT in Section 4 of the UIPT Act, 1958

(a) Buildings and lands other than those leased in perpetuity, owned by the federal government.
(b) Building and lands other than those leased in perpetuity owned and administered by the Government of the Punjab or a local government as defined in Section 2 Clause (xvi) if the Punjab Local Government Ordinance, 2001 (XIII of 2001);
(c) Buildings and land, the annual value of which does not exceed one thousand and eighty rupees, or one building occupied by an owner for his residences, the annual value of which does not exceed one thousand and six hundred and twenty rupees. Subject to the condition that the owner or any member of his family does not own any other property in that Rating Area. Provided that if such building or land is in the ownership of a person who owns any other building or land in the same Rating Area the annual value of such building or land, shall, for the purposes of this clause; be deemed to be the aggregate value of all buildings and lands owned by him in that area.
(d) Buildings and lands or portions thereof used exclusively for educational purposes including schools, boarding houses and hostels owned by the government or by a body owned or controlled by the government
(e) Public parks, playgrounds and libraries
(f) Buildings and land or portions thereof used exclusively for public worship or public charity including mosques, churches, dharamsalas, gurdwaras, hospitals, dispensaries, orphanages, alms houses, drinking water fountains, infirmaries for the treatment and care of animals and public burial or burning grounds or other places for the disposal of the dead. Provided that the followings buildings and lands or portions thereof shall not be deemed to be used exclusively for public worship or for public charity within the meaning of this Section, namely: Buildings or lands on which any trade or business is carried out unless the rent derived from such buildings or lands is applied exclusively to religious purposes or such public charitable institutions as may be prescribed. Buildings or lands in respect of which rent is derived and such rent is not applied exclusively to religious purposes or to public charitable institutions.
(g) Buildings and lands annual value of which does not exceed rupees forty eight thousand and six hundred belonging to a widow, disabled person or a minor orphan. Provided that where the annual value is more than rupees forty eight thousand and six hundred the tax shall be levied on the amount in excess of the said amount;
(h) One residential house measuring an area up to one kanal (500 sq yds.) owned and occupied for his residence by a retired government servant of the federation or a province. Provided that in this clause government servant shall not include a servant of a body corporate owned, established or controlled by the Federal or Provincial Government.
(i) One self-occupied residential house having an area not exceeding 5 Marlas (125 sq yds.) in Katchi Abadi notified under the law relating to Katchi Abadis.
(k) One residential house, measuring an area up to 5 Marlas (125 sq yds), used for residential purpose, irrespective of its annual value.
Source: Punjab Update on Municipal Finances (August 2005); World Bank Study by the Sidat Hyder Morshed Associates (Pvt) Ltd. Management Consultants

35. Exemptions granted for public properties are not unique to the Punjab. Buildings and land owned by federal, provincial, or local governments are commonly exempt from paying taxes in many countries on the grounds that they serve public functions. Taxing such properties would simply move revenues from one public entity to another. One can argue, though, that public properties belonging to higher levels of government benefit from locally provided services and should compensate local governments accordingly. Canadian municipalities calculate property tax for federal/provincial properties, but do not tax them, although the municipalities instead receive a provincial transfer in lieu of property tax (Tassonyi 2004).

36. Exemptions by value are a popular phenomenon in developing countries. The underlying argument is that they provide a subsidy to the poor. Indeed, this is a valid argument, provided that values actually reflect market values and are not distorted by other exemptions and regulations. A more compelling argument for exemptions of very low value property is that they could potentially improve fiscal performance, thanks to better recovery costs. Thus, value based subsidies could be assessed from both a tax effectiveness and a tax/income ratio perspective. In fact, a well calibrated value based exemption could cover both land based exemptions, the Katchi Abadis and the general 5 Marlas exemption meanwhile targeting the poor more effectively [see (g), (i), and (k) in Box4]. The value based exemption implies higher transaction costs though, but the targeted treatment of the poor and the higher tax revenue by far compensate the higher administrative burden and cost.

37. Of the current set of exemptions, the tax exemption of up to 5 Marlas provides the most cause for concern. The new rule grants tax exemption for all residential houses, measuring up to 5 Marlas (125 sq yds) in area and used for residential purpose. This is irrespective of annual value, and it is no longer limited to katchi abadis. Exemption of small huts, living units, houses in poor residential areas (say up to 50 sq yrs floor space) might be well justified, but a 5 Marla lot in a condensed urban area often hosts a house with up to 400 sq yard floor space unit, which is not small by any standard. The exemption of such properties has augmented the already generous treatment of residential units, and further eroded the tax base as it excludes thousands of rental units, as well as, high value properties. This new rule constitutes a major policy/political intervention in the UIPT, with a major impact on tax revenues. It is conservatively estimated that this measure alone will result in a 25 percent reduction in UIPT revenues.

Limitations on the Tax Rate

38. Tax rates are set by federal or provincial governments in most countries. In many instances, central governments set minimum and maximum rates and allow local governments to set their own rate between these limits. In Punjab, the provincial government has set an initial property tax rate of 20% (with a 5% surcharge on properties over Rs.20,000 ARV) in the 1958 UIPT Law. With the recent amendment to the model Punjab Local Government Ordinance of 2001, municipalities (TMAs) have been granted the authority to set their own rates (subject to the regular strictures on setting tax rates). While TMAs now have a broader mandate; few have been willing to exercise it. So, essentially, provincial rates remain in effect until local governments take the initiative to set different rates.

39. ***Rate setting.*** Devolution of rate setting supports the overall devolution process, but there are overarching consequences that are worth examining. While TMAs now have the authority to set their own rate they seem to have neither clear motivation nor sufficient information to apply their own tax rate policy. Conceptually, a local rate could be either higher or lower than the present 20 + 5 percent provincial rate. However, it is hard to see, why a TMA would set a higher tax rate if it is not aware of the tax capacity of the jurisdiction, has no clear and detailed record on taxpayers or collection rates, and indeed, receives about 22

percent of the tax yield (or sometimes nothing) as a provincial transfer? Thus, the rate reduction might be dangerous, as TMAs may start tax competition within a CDG to boost investments with tax rate preferences or tax exemptions. The above challenges can be addressed by developing a consolidated fiscal database and setting tax rates at CDG levels as a joint motion of the respective TMAs.

40. The Punjab tax rate is around international standards since many countries that collect property tax on ARV basis set tax rates at the 20-25 percent level. Furthermore, when ARV is calculated from capital value of the properties, ARV is often estimated as 8 percent of capital value. Thus the 20% tax on ARV is consistent with a 1.6% tax on capital value, which again is comparable to property tax rates in many countries set at 2 percent of capital value. The 5% surcharge on higher value properties also follows international practices. While there is not much scope for revising tax rates upward, it would be highly inappropriate to reduce tax rates, particularly, in light of the very broad and generous reductions on ARV and exemptions of large groups of taxpayers.

41. **The tax rate and tax base policy** need to be in full harmony since base and rate can play a similar role in tax policy. The UIPT initially stipulated a unified tax base and a fixed tax rate. Then the Government provided reduced property tax rates for industries to encourage investment and to boost the economy. Since 1963, however, the repeated amendments of the UIPT Act have intensively and inconsistently changed the tax base, while leaving the tax rate unchanged. Thus, today there are no rate differences; rather, the ARV base provides strong preferences for various groups of taxpayers. The tax base is inherently sluggish, while the tax rate is a flexible element of the taxation system. From this perspective the Punjab situation is not optimal since preferences provided through ARV rules and reductions are locked in the tax base for 5 years. A simplified tax base with less reductions and exemptions rather than rate preferences would be more flexible, easier to administer, and more effective.

Property Taxation Administration

42. Tax administration is a very complex and rather demanding role that requires significant professional and management capacity on valuation, billing, collection, and enforcement. That is why in most countries administration is shared between central/provincial and local governments. For over 30 years, tax policy and tax administration of UIPT was vested at federal and provincial levels in Pakistan. The Punjab LGO 2001 has changed this landscape by providing an unlimited mandate for Tehsil and Town councils in rate setting, valuation, collection, and exemption. The far-reaching consequences of these new mandates in tax policy and administration are still to be addressed.

43. **Division of functions between central and local bodies.** Local governments in developed countries (e.g. USA, Canada, EU) have strong capacity and very sophisticated instruments for tax administration. Many experts argue that local governments in developing countries should be able to set their local tax rates, but that they are inefficient when compared to higher levels of government (central and provincial) in valuation, billing, collection, and enforcement.

44. Capacity to manage property tax administration varies by city size; larger cities usually have similar capacity and manpower at higher levels of government. For instance, Kampala Municipality, Uganda, has been reasonably successful in managing property taxation, relying on private valuers and collectors, with minimal support from the central government. In Jordan, Amman Municipality has been so successful in administering its property tax since 2000, when it set up its own tax administration, that it is now undertaking collection on behalf of 5 other cities. The districts of Budapest, Hungary, which are similar in size to the TMAs are successful in managing property tax administration and collection with over 90% collection rate (Hegedus 2004). But even very small LGs (less then 10,000 inhabitants) successfully manage and collect own property taxes in Hungary (Kopanyi 2004).

45. The legislative framework for the Punjab UIPT tax administration is consistent with overall devolution, and is comparable to the best international standards. The present framework provides for a right division of labor between provincial and local governments. Namely the E&T Department controls provincial tax policy matters, including preparing/amending ARV tables, setting rules for reductions and exemptions. But E&T also conducts property surveys and collects taxes since TMAs have insufficient capacity. Because of lack of local capacity, it is wise to leave most tax administration functions in the hands of E&T for a while. But, E&T needs to focus gradually on Provincial tax policy and administration functions, enhance its regulatory and oversight functions, and help CDGs and TMAs to gradually take over all the administration functions they are legally permitted.

46. Perhaps a viable arrangement is to develop local tax management capacity to provide the full range of technical improvements, to develop local fiscal databases, and to encourage CDGs/TMAs to take over collection, valuation, and tax management. After a suggested simplification of the ARV tables, some CDGs/TMAs might introduce self-assessment–a successful instrument for broadening the tax base and increasing taxpayers' compliance (Brzeski 2005, Weist 2005, Paugam 1999). During this transition period E&T could continue managing the tax administration, while leaving the CDGs/TMAs with the power to set their own rate and define the rating area, as at present. To help CDGs/TMAs decide which option to pursue, they should be given access to sufficient information to judge whether their arrangement is more effective than having E&T do the work or not.

47. ***Valuation of properties*** for property tax purposes is a local function in many developed countries, but it is a central function in most developing countries. The practice is not uniform, though, and in some industrialized countries (Sweden, France, and the UK), central agencies handle valuation. A growing number of developing countries have devolved valuation functions to the local governments, while allowing them to use the service of the central government valuation authority, or hire private assessors under the guidance and control of the central valuation authority.

48. Punjab follows the latter practice, since TMAs are entitled to carry out valuation, but have neither capacity nor expertise. A long-term solution could be to use E&T valuation for updating the ARV tables and provide external service to CDGs and TMAs in the large cities. TMAs in other smaller Districts could strengthening their role in exercising their functions in

valuation, such as making decisions on updating or changing rating areas, capturing new properties, and applying inflation adjustment between five-year revaluations. For instance, TMAs could utilize their building permit records for assessing and taxing new properties immediately after completion.

49. ***Billing and collection*** has thus far been carried out by the E&T Department. The process is that property taxes are levied in June-July, and tax bills distributed in July-August. As specified by law, anyone who pays the tax in full before the end of August is entitled to a 5% rebate. Higher tiers of governments often collect property tax with the yields being paid to the respective local authorities. In Europe this approach is used by almost half of the local governments. Similarly, the Punjab UIPT is currently collected by the E&T Department. There is no compelling reason to radically change this arrangement and it is likely that some TMAs would prefer that the management of the tax assessment, billing and collection is done on their behalf. One major change worth considering in large cities is to organize, record, and manage collection at the CDG level under the guidance and regulatory oversight of the E&T Department, in order to enhance consistency, ensure fair tax coverage and encourage joint efforts of TMAs and District government for improved collection.

50. Under the post devolution scenario, the UIPT collection was devolved to the local governments. Under the PLGO 2001, UIPT was to be collected through the district governments who would have retained 10% as a collection charges and passed on the remaining 90% to the respective TMAs from whose jurisdiction the UIPT is collected. As a result, the Lahore CDG has nearly doubled tax revenues. However, under the PLGO amendments of June 2005, the collection through the district governments has been withdrawn and reverted to the provincial E&T department. This reversal is presumably due to the view that the local governments do not have sufficient capacity, without consideration of the need to develop such capabilities at the local level. This could be true in regular districts, but the five CDGs should have sufficient capacity and involvement in local tax administration, billing and collection similarly to the rules applied by the Board of Revenues in the land revenue collection. The Punjab Land Revenue Act 1967 stipulates (section 10) that the Government/ Board of Revenue may confer on the Deputy District Officer (Revenue) of a Tehsil all or any of the powers of the local Collector.

51. Payment administration suffers from shortcomings and weaknesses. Payment of UIPT tax can be made into any local branch of the National Bank. The bank sends the paid tax-bill stubs to a central office of E&T where they are sorted by zone and tax circle, and then sent to the tax circle to be entered in the (manually maintained) register. From the perspective of financial control this process has several weaknesses, notably the lack of control totals on the number of stubs or on the amount collected. The numbering sequence of the stubs received in any circle has numerous breaks due to taxes being received for other zones or arising from collection of other taxes. There does not appear to be control to ensure that all entries are transferred to the registers. Given these weaknesses there is plenty of opportunity for error in crediting collections.

52. The unreliable collection records and the low collection rate (55% in 2004/05) indicate several shortcomings in current tax administration. International experience suggests that by

enhancing tax administration and the billing and collection system, the Punjab local governments could double if not quadruple their property tax revenues. For local governments to realize the full revenue potential of the UIPT, they need to be well informed about and involved in managing the local tax base, tax capacity, valuation, billing and collection. At the local level, establishing a solid, sound, reliable, and up-to-date fiscal database is a vital step in enhancing the UIPT system. Furthermore, the billing and collection system needs detailed analysis, and would be well suited for computerization, along with automation of other parts of the tax administration.

53. **Enforcement and Legal Remedies**. There is a detailed regulation for enforcement and legal remedies by and large at international standards (sections 10 through 16 of UIPT Act). The key elements include rules such as tax to be levied notwithstanding pending appeals. Tax arrears can also be recovered from tenants. The tax authority (District Collector, District Commissioner, and E&T) can impose a penalty on overdue tax up to 100% of the outstanding amount. Unpaid dues can also be recovered by distress or sale of movable property, attachment or sale of immovable property. Finally, un-recovered dues and penalties shall be recoverable as arrears of land revenue (presumably by the Board of Revenue). The local authority can collect taxes/penalties and entitled to retain remuneration for cost of collection means that the CDG can collect UIPT in case a TMA fails doing so. The valuation roll should be published and owners can appeal to the assessing authority within thirty days, but the Civil Court jurisdiction in UIPT matters is excluded.

54. Despite some serious shortcomings of the present banded ARV system, Punjab tax payers are not lining up to appeal their tax bills. This is partly due to the very low level of property tax compared to average revenues and the very generous exemptions and reductions. However, there are strong indications that informal pressures and bargaining are used to reduce the tax burden by some categories of taxpayers. Many of the present reductions and exemptions are likely due to formal or informal pressure on the E&T Department.

55. The enforcement rules are fair and valid, but effective only to the extent they are actually implemented. For instance, the demand note does not include any detail on overdue taxes; instead one box is retained for indicating the present (accrued) arrears. No box is retained for indicating penalties, and likewise there is no certified account stipulated for arrears with conclusive proofs (the section 79 of the LRA provides for a good example). Consultations suggest that neither penalty nor enforcement actions form a substantial part of the present tax administration functions.

56. ***Monitoring and evaluation*** of the property tax system is a missing task in the Punjab UIPT system. There is a need to continuously monitor tax effectiveness even in countries with long traditions in, and well functioning, systems of property taxation. This monitoring should include an impact analysis of the various tax instruments, cross comparison of the various rating zones and clusters of tax payers by conducting ratio studies compare collection rate by zone and initiate actions for improvement. In fact, the present ARV system could be greatly improved with a detailed impact evaluation.

Recommendations

57. Compared to most developing and transition economies Pakistan has a relatively long experience in taxing real properties. Repeated improvement efforts signal the Punjab Government's eagerness to develop a robust legislative and institutional framework for UIPT. The key conclusion of the study is that the property tax plays a negligible role in Punjab local finances; UIPT is not a real local tax and both the yield and its share in local revenues are very low by international comparison. This study has pinpointed a range of impediments, inter alia, ambiguous fiscal policy regarding the role of property taxes, narrow tax base, broad and distorting exemptions and reductions, ill-calibrated annual rental value of some property categories, ineffective tax administration, low collection rate, and unreliable collection records. In this section we outline a range of recommendations for improving the property taxation in Punjab.

58. Our recommendation approach is based on the notion that the reform agenda should be comprehensive, and coherently link together a range of needed actions. The achievement of the desired benefits would require developing a Provincial action plan and launching policy dialogue aiming to reach a political consensus on streamlining the UIPT system, enhancing its consistency, and increasing revenue capacity. There are several measures that can be implemented in a very short timeframe since they do not require major changes in the legislative or institutional framework. A number of more fundamental changes, however, can only be implemented and achieved in the medium or long time horizon.

Recommendation 1: Strengthen property tax among fiscal revenues and form UIPT as real and significant local own-source revenue

It is imperative to adopt a Provincial action plan aimed at streamlining the property tax system, allocating functions across provincial and local authorities in order to substantially increase the tax revenue capacity. A detailed assessment of the revenue potential and analysis of the role of UIPT yield among local revenues could be the first steps in the action plan. This would serve to start a broad and constructive policy dialogue for enhancing the legislative and institutional framework in order to substantial increase UIPT revenues.

An imminent action could be to account for UIPT as a local own source revenue collected on behalf and returned to the respective local governments without intercepting, instead of treating UIPT proceeds as provincial transfers. The major steps would include: (i) the Province gives its 15% share to the LGs in agreed proportions to CDGs and TMAs; (ii) the province intercepts regular transfers but let UIPT be returned fully to the origin jurisdictions (beyond the 5% collection fee); (iii) the CDGs account all UIPT shares due and transfers to the TMAs their entitlements; and (iv) the CDG accounts as expenditures all outflows provided from UIPT proceeds to water, development agency or other entities under the CDG jurisdiction.

Recommendation 2: Broaden the tax base in order to increase UIPT revenue capacity without unnecessarily increasing tax burden for those who pay UIPT

Broadening the tax base is of crucial importance. The tax base is not only narrow in scope, but also fails to capture a large share of legally taxable properties. Two major steps can be taken: capturing all taxable properties within the jurisdiction of TMAs and CDGs; and narrowing exemptions and reductions. With these steps local revenues would significantly increase. The PLGO 2001 opens the way for including not only new residential areas, but also more importantly all the new commercial and industrial development which has taken place alongside main roads in the property tax net.

Broadening the tax base time wise is also a critical issue. Between two on-site examinations, the ARV unit values can be adjusted by accounting inflation. This very simple and easily applicable measure would reduce and mitigate the shocking increase that occurs every five year; meanwhile it would improve buoyancy of the property tax yield for the local governments. This can be done either as a general Provincial rule or when requested as a joint motion of a CDG and the E&T Department (a demand driven solution).

Recommendation 3: Narrow reductions and exemptions; revise the 5 Marla exemption

A thorough revision and narrowing of reductions and exemptions is of crucial importance. A major functional inconsistency of the present UIPT system is that the reductions and exemptions in fact overwrite the ARV tables, hence severely distorting, while aiming to correct them (e.g. the ARV for industrial properties is listed among reductions). A detailed impact assessment is inevitable for appraising the real effects, effectiveness, and deficiencies (ill-targeted subsidies, lost revenues) of the reductions and exemptions.

Of all the changes, the exemption of all residential properties up to 5 Marlas (125 sq yard) plot area most significantly reduces the property tax base. If the aim is to support poor families, the 5 Marlas plot that may host a house with over 400 sq yard floor space is too large area to exclude, especially when compared to international experience. An exemption based on value or on the floor space (say 50 sq yrd) rather than the land area would target the poor much better. It is very likely that this exemption includes numerous high value properties as well as rented units, and is conservatively estimated to reduce the tax yield by 25%.

Recommendation 4: Simplify ARV tables and align with each other in order to enhance equity, fairness, efficiency of UIPT

The ARV tables conceptually provide good, simple, and transparent ground for property valuation, but are inconsistent and distorted. There are also deficiencies in valuing various property groups, and in using ARV for granting subsidies. The major anomaly of the system at present is that industrial properties are valuated on the basis of residential ARV rates; so industries might be under taxed, while commercial services overtaxed.

The next revaluation of the ARV tables is due in 2007. There are several measures, however, that can be implemented immediately since they do not require on-site revaluation or major legislative changes. Other measures can be implemented in 2007, or may need even longer time.

Two major short term measures are to: (i) introduce separate ARV table for Industrial properties, rather than listing them among exemptions; (ii) simplify the ARV tables for commercial and industrial properties and apply a sole rental ARV for both self-occupied and rented properties. No compelling arguments justify the different ARV for rented and self-occupied industrial and commercial properties.

In the medium term, the ARV tables need to be substantially revised, harmonized, and aligned with each other. The subsequent changes in market values will inevitably have a big impact on the ARV unit values. But, based on detailed impact assessments in different property categories, the ARV unit values need to be recalibrated in order to improve equity and efficiency of the property taxation. One key medium term objective of the ARV recalibration should be to continue radical reduction the ARV difference between self-occupied and rented *residential* properties.

Recommendation 5: Revise and enhance rental value appraisal in order to mitigate the impact of rent control

One of the major shortcomings of the present ARV system is that the ARV is calculated in a very shallow rental market (1/3 of total properties rented) where there is substantial rent control. In medium term, the calculation of the ARV values can hence be improved in order to mitigate the distortion effects of shallow rental markets and rent control. While there are several possible solutions, two are highlighted below.

First, in medium term, one solution would be to calculate rental value as a ratio of the fair market value of the property. For example, ARV = 8% of the market value of the property (the price the owner could sell to a willing buyer). This would allow use of the banded rental value system with ARV tables based on this new valuation of the band rental value. This would enhance the relevant database for the ARV tables for all properties, but particularly adequate for assessing ARV for industrial and commercial properties. This proposal is similar to the E&T plan 2001, but this might be feasible if the value estimates are put into the context of the ARV table system. That means the basic tenet of the system remains valid, namely floor space based banded unit value.

Second, enhancing the sampling of the ARV valuation provides for another good alternative. In aggregating the current rental fees during the ARV updating, the length and time of the rental agreement can be taken into consideration and bigger weight can apply for the recent 1-3 year rentals.

Recommendation 6: Enhance tax administration by establishing a sound fiscal database and involving TMAs and CDGs in tax administration functions

The legislative framework for the UIPT tax administration is at international standards and is in harmony with the overall devolution program, but is not yet implemented. The most fundamental impediment is that local governments (CDGs and TMAs) are uninformed, and insufficiently involved in tax administration; rather, they are passive beneficiaries of UIPT yield received in the form of provincial transfer. In order for the local governments to realize their revenue potential, they need to be well informed and involved in managing the local tax base, tax capacity, valuation, billing and collection.

Short term measure: a monitoring and evaluation framework should be established with no delay. This could include impact analysis of the various tax instruments, cross comparison of the various rating zones and clusters of tax payers by comparing collection rate by zone and initiating actions for improvement.

Three major measures can be implemented in the medium term. There is a need for a transition period to gradually build local capacities and devolve tax policy and administration functions, respectively. First, during a transition period E&T could continue managing the tax administration, but leave the CDG/TMAs with the power to set their own rate, define the rating area, and capture new properties. Second, it is urgent to establish a solid, sound, reliable, and up-to-date fiscal database at the local level (joint CGD/TMA). Third, for harmonizing and strengthening tax administration in Punjab large cities, it is vital to revise the role of CDGs and then exercise tax administration functions jointly with CDG and TMAs along with the intentions of the PLGO 2001 rules.

Recommendation 7: Enhance the billing and collection system in the course of introducing an automated/computerized tax administration system.

A key short term measure would be to organize and manage billing and collection at CDG level in cooperation with the incumbent TMAs in order to enhance consistency, ensure fair tax coverage, and encourage joint efforts of TMAs and District Government for improving collection.

In medium term, the billing and collection system needs detailed analysis and would be well suited for computerization, along with automation of other parts of the tax administration. For example, there is scope to link assessment, demand and collection to an IT-based Graphical Information System (GIS) over time.

Recommendation 8: Develop and implement a comprehensive capacity building program for enhancing tax administration at TMS and CDG level in order to enable gradual devolution of tax administration functions

GoPunjab should develop local tax management capacity to provide the full range of technical improvements, to develop local fiscal databases, and to encourage TMAs to gradually take over self-collection, valuation, and tax management functions. Various bilateral and multilateral funds are accessible for developing the curricula and for preparing and implementing a detailed capacity building program. The Punjab large cities could be the best candidates for testing and finalizing the capacity building program, which can then be rolled out for the secondary cities in Punjab.

Recommendation 9: Implement the rules set for Enforcement and Legal Remedies

The rules for enforcement and legal remedies are sufficiently detailed, complete, consistent, and developed at international standards. However, there are a number of actions the CDGs and E&T Department could take jointly in the short term to improve enforcement and legal remedies. First, set up a necessary institutional/organizational framework for applying the legal rules. Second, develop and analyze a sound database for the property tax arrears in each District and CDGs. Third, setup a certified account for collecting arrears similar to the account used for the land revenue collection. Fourth, modify form PT-10 of the demand note in order to clearly indicate to the tax payers their arrears, penalties, reductions, and exemptions.

Annex Table 1
Residential property valuation table

Residential Property - ARV Valuation Table									
Category		Self Occupied				Rented			
		Land Rental Value (Rs/sq yd)		Building Rental Value (Rs./sq ft)		Land Rental Value (Rs/sq yd)		Building Rental Value (Rs./sq ft)	
Class	Property situated Main/Off Roads	Up to 500 sq yds.	Over 500 sq yds.	Up to 3000 sq ft.	Over 3000 sq ft	Up to 500 sq yds	Over 500 sq yds	Up to 3000 sq ft	Over 3000 sq ft
A	Main Roads	0.4	0.3	0.4	0.3	4.0	3.0	4.0	3.0
	Off Roads	0.3	0.25	0.3	0.25	3.0	2.5	3.0	2.5
B	Main Roads	0.3	0.25	0.3	0.25	3.0	2.5	3.0	2.5
	Off Roads	0.25	0.2	0.25	0.2	2.5	2.0	2.5	2.0
C	Main Roads	0.25	0.2	0.25	0.2	2.5	2.0	2.5	2.0
	Off Roads	0.2	0.15	0.2	0.15	2.0	1.5	2.0	1.5
D	Main Roads	0.2	0.15	0.2	0.15	2.0	1.5	2.0	1.5
	Off Roads	0.15	0.1	0.15	0.1	1.5	1.0	1.5	1.0
E	Main Roads	0.15	0.1	0.15	0.1	1.5	1.0	1.5	1.0
	Off Roads	0.1	0.05	0.1	0.05	1.0	0.5	1.0	0.5
F	Main Roads	0.12	0.06	0.12	0.06	1.2	0.6	1.2	0.6
	Off Roads	0.08	0.04	0.08	0.04	0.8	0.4	0.8	0.4
G	Main Roads	0.09	0.05	0.09	0.05	0.9	0.45	0.9	0.45
	Off Roads	0.07	0.04	0.07	0.04	0.7	0.35	0.7	0.35

Annex Table 2
Commercial property valuation table

Commercial Property - ARV Valuation Table											
Category		**Self Occupied**					**Rented**				
		Land Rental Value (Rs. / Sq yd)		Building Rental Value (Rs./sq. ft)			Land Rental Value (Rs. / Sq yd)		Building Rental Value (Rs./sq. ft)		
Class	Property situated Main/Off Roads	Up to 500 sq yds	Over 500 sq yds	1 to 1500 sq ft	1501 to 3000 sq ft	Over 3000 sq ft	Up to 500 sq yds	Over 500 sq yds	1 to 1500 sq ft	1501 to 3000 sq ft	Over 3000 sq ft
A	Main Roads	2.4	1.4	2.4	2	1.4	12.0	7.0	12.0	10.0	7.0
	Off Roads	2.0	1.2	2	1.6	1.2	8.0	6.0	10.0	8.0	6.0
B	Main Roads	1.6	1.2	1.6	1.4	1.2	8.0	6.0	8.0	7.0	6.0
	Off Roads	1.4	1.0	1.4	1.2	1.0	7.0	5.0	7.0	6.0	5.0
C	Main Roads	1.4	1.0	1.4	1.2	1.0	7.0	5.0	7.0	6.0	5.0
	Off Roads	1.0	0.6	1.0	0.8	0.6	5.0	3.0	5.0	4.0	3.0
D	Main Roads	1.0	0.6	1.0	0.8	0.6	5.0	3.0	5.0	4.0	3.0
	Off Roads	0.8	0.5	0.8	0.6	0.5	4.0	2.5	4.0	3.0	2.5
E	Main Roads	0.8	0.5	0.8	0.6	0.5	4.0	2.5	4.0	3.0	2.5
	Off Roads	0.5	0.3	0.5	0.4	0.3	2.5	1.5	2.5	2.0	1.5
F	Main Roads	0.64	0.4	0.64	0.4	0.3	3.2	2.0	3.2	2.0	1.5
	Off Roads	0.4	0.25	0.4	0.25	0.2	2.0	1.25	2.0	1.25	1.0
G	Main Roads	0.5	0.32	0.5	0.32	0.25	0.5	1.6	2.5	1.6	1.25
	Off Roads	0.32	0.2	0.32	0.2	0.16	1.6	1	1.6	1	0.8

Annex Table 3
Industrial property valuation table (a valuation option)

Industrial Property - ARV Valuation Table (a possible solution)											
Category		**Self Occupied**					**Rented**				
		Land Rental Value (Rs/sq yd)			Building Rental Value (Rs./sq ft)		Land Rental Value (Rs/sq yd)			Building Rental Value (Rs./sq ft)	
Class	Property situated Main/Off Roads	Up to 4000 sq yds.	4000 - 20000 sq yds.	Over 20000 sq yds.	Up to 3000 sq ft.	Over 3000 sq ft	Up to 4000 sq yds	4000 - 20000 sq yds.	Over 20000 sq yds	Up to 3000 sq ft	Over 3000 sq ft
A	Main Roads	0.4	0.32	0.24	0.4	0.3	4.0	5.6	4.2	4.0	3.0
	Off Roads	0.3	0.24	0.18	0.3	0.25	3.0	4.8	3.6	3.0	2.5
B	Main Roads	0.3	0.24	0.18	0.3	0.25	3.0	4.8	3.6	3.0	2.5
	Off Roads	0.25	0.20	0.15	0.25	0.2	2.5	4.0	3.0	2.5	2.0
C	Main Roads										
	Off Roads										
D	Main Roads										
	Off Roads										
E	Main Roads										
	Off Roads										
F	Main Roads										
	Off Roads										
G	Main Roads										
	Off Roads										

Annex Table 4
Comparison of Gross ARV for Industrial and Commercial Properties in Gulberg, Lahore

Industrial Properties in Gulberg, Lahore

Property Name	Land area (sq. yds)	Covered Area (sq. ft)	Assessment Category
Medium Size Printing Press	5,000	24,609	Self – A
Beverages Factory – A	11,100	42,587	Self – A
Medium Size Textile Mill	4,000	18,860	Self – A
Beverages Factory – B (Unit II)	2,275	10,375	Self – A
Beverages Factory – B (Unit III)	3,450	9,608	Self – A

Monthly rental value Land (Rs.)			Monthly Rent – building (Rs.)			
first 500 sq. yds @ 0.40	Next 3500 sq yds @ 0.30	Balance area @ 0.24	first 3000 sq. ft @ 0.4	Balance area @ 0.3	Total monthly rent (Rs.)	Gross ARV (Rs.)
200	1,050	240	1,200	6,483	9,173	110,072
200	1,050	1,704	1,200	11,876	16,030	192,361
200	1,050	-	1,200	4,758	7,208	86,496
200	533	-	1,200	2,213	4,145	49,740
200	885	-	1,200	1,982	4,267	51,209

Commercial Properties in Gulberg, Lahore

Property Name	Land area (sq yds)	Covered Area (sq. ft)	Assessment Category
Medium Size Departmental Store	550	24,560	Self – A
Medium Size Hotel	707	30,500	Self – A
Medium Size Bakery	107	960	Self – A

Monthly rental value Land		Monthly Rent - building				
First 500 sq. yds @ Rs.2.40	Exceeding 500 sq yds @ Rs.1.40	First 1500 sq. ft @ Rs.2.40	15001 - 3000 sq. ft @ Rs 2.00	Exceeding 3000 sq ft @ Rs.1.40	Total monthly rent (Rs.)	Gross ARV Rs.)
1,200	70	3,600	3,000	30,184	38,054	456,648
1,200	290	3,600	3,000	38,500	46,590	559,078
257	-	2,304	-	-	2,561	30,730

Annex table 5   UIPT Demand Note

Book No. Sr.No.	FORM PT-10 (See Rule 15(4) & (5) of the Punjab Urban Immovable Property Tax Rules, 1958)

Rating Area	Zone	Property No.	Locality	Demand No.	Issue Date	Due Date for Payment

Name of Owner's) with parentage	*Four years tax payment detail*		
	Year	Tax Due (Rs)	Tax Paid (Rs.)

Land area (In Sq.Yd.)	Covered Area (in Sq.Ft.)	Type of Property (commercial / Residential/ Special)	Usage (Self/rented)	Category of Valuation Tables applied for assessment	Situated on Main Road / Off Road	Rate of Valuation Tables per Sq.Yd/Sq.Ft. applied for assessment

Tax Calculation	Current Year's Tax	Rs.(In figures & words)
i). Allowance on account of age of property ii). Allowance on account of furniture	Current year's tax with 5% rebate, if paid on or before 31st August	Rs.(In figures & words)
	Arrears for the year_______. If any	Rs.(In figures & words)
	Total Tax Payable	Rs.(In figures & words)

Challan Prepared by with signatures		Challan Checked by with signatures		Name & Seal of Assessing Authority	

For use by Treasury

Challan No.		Number of Entry in Tax Receipt Register		Date of entry in Tax Receipt Register	Amount Received	Rs.(in figures & words)	Signatures of Treasury Officer with Treasury Stamp

Source: E&T Department

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