Centre for Affordable Housing Finance in Africa

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Taxation and Affordable Housing in Africa

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Abstract

Taxes have a direct impact on housing affordability in Africa by making various cost components more expensive and others less so. Taxation also impacts housing affordability indirectly by stimulating or discouraging investment in housing. Taxes related to housing fall into three broad categories: direct taxation of housing-related income (taxation of both corporate profits and personal income); indirect taxation of housing-related goods and services consumed by both firms and households; and taxation of wealth held in the form of real estate, including property taxes, transfer fees and capital gains tax. This paper proposes a taxonomy of housing-related tax instruments which demonstrates where and how each type of tax potentially impacts the housing value chain, from housing construction, to sale, rental, and resale. The objective is to identify how the current taxation systems in different African countries impact directly or indirectly on housing investment and affordability for both rental and owner-occupied dwellings.

Direct taxation instruments for individuals which impact on housing include tax (and exemptions) on personal rental income; deductions of interest paid on mortgages; and tax reliefs on mortgage-backed securities and on earnings from infrastructure bonds. For corporates, there are tax relief schemes targeted to developers of affordable housing and Real Estate Investment Trusts. Such instruments can reduce costs at an individual household level and can increase the supply of affordable housing by incentivizing investors.

The main indirect taxation instruments which impact the housing value chain are the value added tax (VAT), sales tax and import duty which will increase costs of building materials, plant and equipment, building contracts, professional services and financial transactions. Such taxes have the potential to raise the cost of housing delivery and directly reduce affordability of the final product for the end-user, unless effective tax relief measures are put in place to mediate this impact.

The primary instrument for wealth taxation is the property tax which may be levied upon the value of the land alone, or the full value of land and improvements. Non-recurrent taxes that are levied upon property sale, gifting or inheritance (including stamp duty, capital gains tax, gift taxes, and death and inheritance taxes) can negatively impact on affordable housing by discouraging land and housing transactions and thus hampering the churn and mobility of housing markets. Property tax relief instruments include extensive tax holidays for newly developed or renovated residential properties and exclusions up to a certain threshold of property value.

This paper argues that efforts to reform the tax system in order to enhance housing affordability should focus on rectifying the main shortfalls evident in the current instruments: potential unintended negative consequences; inefficiency; and poor design. In addition, the paper identifies the type of data which ought to be collected on an ongoing basis to support the information needs of housing investors and policy-makers.

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Introduction

The primary goal of taxation is to enable governments to raise revenue to finance public goods and services such as infrastructure, public health, basic education and defence.[1] In addition, taxation provides governments with policy tools to target or otherwise influence market activities and performance, as well as the behaviour of economic agents. Housing taxes are a part of this wider system of taxation.

Taxes can have a major impact on housing supply and affordability.[2] They have a direct impact on affordability by making various cost components more expensive and others less so. Taxation can also have an indirect impact on affordability: it can stimulate investment in housing and boost supply and in that way, temper housing prices and rents. It can also make investment in non-residential real estate more attractive and thus suppress housing supply, undermining affordability. Although taxation impacts on the housing market in its entirety, the concern of this paper is the affordable housing segment.

Affordability can be gauged by the proportion of urban households that can afford the cheapest newly built house by a formal developer. Examples of countries where this proportion is tiny are South Sudan (0.1 percent, Burundi (0.7 percent), Eritrea (0.8 percent) and Uganda (3.5 percent). A number of other countries have moderate affordability levels such as South Africa (35.8 percent), Ethiopia (35.9 percent), Botswana (39.8 percent), Namibia (44.5 percent) and Gabon (46.2 percent). The best performers include Algeria (81.3 percent), Egypt (83.9 percent), Morocco (90.8 percent) and Cote d'Ivoire (96 percent).[3] However, due to the lack of systematic data across countries, we know less about the overall impact of taxation on housing affordability.

The first objective of this analysis is to examine the taxation of housing within the broader setting of taxation systems. The aim is to understand taxation and where it arises in the overall housing value chain and housing finance value chains. Towards this end, a taxonomy has been proposed of the taxes and tax reliefs that impact on housing during its construction, sale and resale, while also taking into account the taxes that affect rental and owner-occupied dwellings. For purposes of classifying housing taxes, the paper uses the broad tax bases found in public finance literature: direct taxation of income, indirect taxation of goods and services, and taxation of wealth. An important feature of the proposed taxonomy is that it is well-understood by policy makers in ministries of finance whose approach to fiscal policy has traditionally been informed, in large part, by public finance theory.[4] Experience has shown that reforming housing taxation, and indeed taxation at large, is not possible without the support of these officials.

The second objective is to identify how the current taxation systems in different African countries impact directly or indirectly on housing investment and affordability. Several aspects of housing are considered: its delivery, its trade and financing, the investment it is able to attract, and ultimately, its cost. In this regard, the unintended consequences of tax for the housing market are also given attention. These include the indirect effects of taxation and tax reliefs on other forms of property investment.

The third objective is to identify the type of data that should be collected on an ongoing basis that would be useful for supporting the information needs of housing investors and policy makers. The data collected would also help fiscal authorities to design housing taxes that meet the criteria generally used to evaluate taxation systems.[5]

The rest of the paper is organized as follows:

- Section 2 provides an overview of taxation and sets out the main economic and fiscal objectives of tax systems as well as the criteria for evaluating them.
- Section 3 puts forward a taxonomy of housing taxes and examines the impacts of these taxes with a focus on the costs of provision, investment, and affordability. The section also examines the unintended consequences of taxation on housing.
- Section 4 begins to evaluate housing taxes against the cited criteria and speaks to potential directions and areas for tax reform.

1. The Organization for Economic Cooperation and Development (OECD) defines a tax as a "compulsory unrequited payment to the government". See: http://www.oecd.org/ctp/glossaryoftaxterms.htm. Property tax, in contrast, can be viewed as a benefit charge linked to the use of publicly provided services. See, for instance, Franzsen, R. and McCluskey, W. (eds.) (2017). Property Tax in Africa. Status, Challenges, and Prospects. Lincoln Institute of Land Policy, Cambridge, Massachusetts. p.30.
2. In Zambia, for instance, evidence indicates that Value Added Tax and property transfer tax increase the cost of affordable housing by as much as 22%. Source: data from a small survey for this study. A brief questionnaire on aspects of housing taxation was designed and administered online to members of the African Union of Housing Finance Institutions. There were returns from 7 respondents representing 7 countries.
3. Centre for Affordable Housing Finance in Africa (CAHF) (2016). ***Housing Finance in Africa: A Review of Some of Africa's Housing Finance Markets***. 2016 Yearbook.
4. In large part, since politics also comes into play.
5. See Section 2.

Taxation: An Overview

Taxation systems vary widely across countries and generally reflect the broad political and economic policies of each jurisdiction. The three core objectives of taxation are:

- To provide revenue to finance necessary government expenditure;
- To act as an instrument to achieve the economic aims of government; and
- To redistribute income on a socially acceptable basis.[6]

Following Mirrlees *et al.* (2011), South Africa's Davis Tax Committee set out the following criteria for evaluating tax systems:

- *Economic efficiency*, which requires that revenue be raised in a manner that does not cause distortions in the economy, for instance by altering the behaviour of economic agents in a way that deters economic growth and investment.
- *Administrative efficiency*, which seeks to simplify tax administration and minimize compliance costs.
- *Equity*, which distinguishes two concepts: horizontal equity which requires similar tax treatment for people in similar economic circumstances, and vertical equity which seeks to ensure progressivity[8] by ensuring that people in different economic circumstances are treated differently.
- *Fairness* (other than in the distributional sense), which is concerned with fairness of procedure and avoidance of discrimination.
- *Transparency and certainty*, which mainly requires that a tax system be easy for people to understand.
- *Revenue buoyancy*, which gauges how tax revenues respond to economic growth with the main concern of ensuring government's ability to raise revenue during all phases of the business cycle.[7]

Some of these criteria, by their nature, have conflicting outcomes. One example is a tax that is equitable but which is less effective in raising revenue than a more regressive tax. Another is a low tax on domestic fuel which seeks to improve equity but which would probably be ruled out on environmental grounds. Not every tax needs to be progressive as long as the whole tax system is progressive. In Section 4 these criteria have been employed to evaluate the main taxes on housing.

An examination of the impact of taxation should distinguish between the statutory obligation to pay a tax and the economic or actual incidence which seeks to determine who actually bears the tax burden. Economic incidence investigates whether:

- The tax is borne entirely by the seller of a good or service;
- The tax can be shifted entirely to the consumer; or
- The tax is shared between the party that bears the statutory duty to pay and the consumer.

Economic incidence is influenced by market conditions. In imperfect markets, of which housing markets are a classic example, taxes and tax-related reliefs are, in principle, shared between the party with the statutory obligation to pay and the intended beneficiary of the tax. This means, for instance, that a tax on residential buildings is likely to be shifted from the building owner to the tenants. Tax incidence is especially critical for low income residents who have a much smaller margin of affordability to bear the tax than high income owners or renters. In examining the impact of specific taxes and tax reliefs on housing, this paper draws attention to tax incidence and its implications (See Tables 1, 2 and 3).

Another important dimension of the impact of taxation stems from its use as an incentive or disincentive to influence economic behaviour. In certain circumstances, a tax regime may encourage greater or less investment in affordable housing than would otherwise be the case in normal market circumstances.

6. Reproduced from Alley, C. and Bentley D. (2005) "A Remodelling of Adam Smith's Tax Design Principles", citing Report of the Taxation Review Committee, Taxation in New Zealand (1967). See: http://epublications.bond.edu.au/cgi/viewcontent.cgi?article=1044&context=law_pubs
7. Davis Tax Committee (2015). "The Tax System and Inclusive Growth in South Africa: Towards an Analytic Framework for the Davis Tax Committee". Macro Analysis First Report Executive Summary. See: http://www.taxcom.org.za/docs/20150605%20DTC%20First%20Macro%20Analysis%20Report%20-%20Executive%20Summary.pdf
8. A tax is progressive if the proportion of income that goes to tax rises with income.

A Taxonomy of Housing Taxes and Their Impact

Taxes on housing can be classified into the following broad categories:

- Direct taxation of housing-related income (taxation of both corporate profits and personal income)
- Indirect taxation of housing-related goods and services consumed by both firms and households (expenditure taxes)
- Taxation of wealth held in the form of residential real estate, commonly referred to as property taxes or property rates

Each of these taxes impacts upon one or more components of the housing value chain. Table 1 provides an overview of where each of the main tax instruments discussed below primarily impacts upon the housing value chain.

Table 1: Impact of taxes along the housing value chain

Housing-related asset, financial stream or transaction along the value chain	Categories of taxes		
	Direct taxation of housing income	Indirect taxation of housing-related goods and services	Taxation of housing wealth
Land assembly/acquisition/ titling			• Property rates on land and improvements (separately or combined)
Bulk infrastructure			
House construction, maintenance and improvements		• Sales tax on building materials, plant and equipment • VAT on building materials, plant and equipment, and professional fees • Import duty on building materials, plant and equipment	
Sales, re-sales and transfer		• VAT on property sales and re-sales	• Capital gains tax • Property transfer taxes • Estate/inheritance tax
Housing income	• Personal income tax on residential rent • Corporate tax on rental income		
Securities (e.g. Asset-backed securities and REITs)	• Corporate tax on income from residential REITs • Withholding tax on income from mortgage-backed securities	• Sales tax on securities • VAT on asset-backed securities and REITs	

These taxes will be examined here together with their accompanying reliefs. The impact of taxation and reliefs will also be reviewed with a focus on:

- Direct impact on housing investment, affordability and targeting of different market segments;
- Indirect impact on housing investment and affordability; and
- Unintended consequences for housing arising from different tax treatment of investments in other types of real estate.

Direct taxation of housing income

Taxes on housing income

When housing is offered for rent it generates rental income for its owner. Property companies and individuals can also generate taxable income from the sale of new and existing housing. Other income attributable to housing comes from investments in asset-backed securities issued by property companies or from units sold by real estate investment trusts (REITs). Income from all of these sources is usually taxed.[9]

Tax reliefs

Tax authorities grant reliefs on direct taxes to temper the impact of housing taxation. In particular, these reliefs seek to reduce the tax burden on lower-income households and thus raise affordability. Another goal is to influence investor behaviour with the aim of stimulating more investment in housing.

For individuals, examples of these reliefs include:

- Tax-free rental income if it falls below a given threshold;
- Mortgage interest relief whereby the interest paid on a mortgage loan for an owner-occupied house (typically the primary house) is deducted, within limits, from taxable personal income;
- Tax reliefs in respect of interest earnings from savings deposits held in housing finance institutions; and
- Tax reliefs on mortgage-backed securities and on earnings from infrastructure bonds.

For corporates, tax reliefs include:

- Corporate tax relief for developers of affordable housing whether for rental or sale;
- For REITs, minimal or no taxation of corporate profits provided that a high proportion of profits is distributed;[10] and
- Tax reliefs on earnings from savings deposits held with housing finance institutions, on mortgage-backed securities, and on earnings from infrastructure bonds.

Impacts of direct taxes

Direct taxation of income from housing, for individuals and corporates, reduces profits and the rate of return on investment. Investment in housing could fall and constrain supply if investors are tempted away by higher returns in the non-residential property market or investment opportunities outside of the land and property markets. Even if investors are disincentivised to invest in high-end residential property only, this will impact on the housing ladder by restricting upward filtering, and thus still ultimately adversely affect the lower end of the market. This outcome would likely be an unintended consequence of tax policy. The end result, in the longer term, would be higher housing prices and rents, and reduced affordability. This outcome would be particularly adverse for low-income households as it would compel them to adjust their housing consumption by living in lower-standard but more affordable housing.

Direct taxes on housing income, if levied to favour one market segment over another, could also influence the types of housing delivered. Thus, if tax breaks favoured low-income housing, then investors would find this type of housing attractive if its risk-adjusted returns turned out to be higher. Equally, if taxes were to be skewed in favour of owner-occupation, individuals could opt to own rather than to rent or may sell second properties they held for rental income—an outcome that might not have been intended by taxing authorities.

Table 2 sets out the respective taxes and reliefs, for both individuals and companies. It also identifies the likely effects of taxes and reliefs on affordable housing, and the implications for the housing value chain and housing finance value chains. Country examples of housing income taxation are given and the key data that should be collected for purposes of creating a dashboard indicated.

9. With regard to owner-occupied housing, an economic case can be made for taxing the imputed rent equivalent to the housing services that the owner enjoys. There seems to be no evidence of this type of tax in Africa, although this type of tax existed in the United Kingdon until 1963—see Mirrlees, J. et al. op.cit. p. 397. It can be argued, however, that since property taxation is found in practically all African countries, taxing imputed rent would be tantamount to double taxation.
10. Rebel Group (2017) "Residential REITs and their Potential to Increase Investment in and Access to Affordable Housing in Africa". Main Report prepared for CAHF.

Table 2: Direct taxation on housing income

Taxes and Tax-Related Reliefs or Subsidies	Potential Impact on Affordable Housing	Possible Implications for the Housing Value and Housing Finance Value Chains	Key Taxation Indicators
Personal income tax relief on residential rental income • *Ethiopia: No tax is due if the total monthly income from rent is less than Birr 7,200 (US$ 330) (2016 data).*[11] • *Kenya: From January 2017, no tax for combined monthly rental income below KES 12,000 (US$ 120).*[12] *Otherwise a 10% withholding tax on rent.* • *Rwanda: No tax for combined monthly rental income below Rwf 180,000 (US$ 216); 20% tax for rent income from Rwf 180,000 to 1 million (US$ 216 – 1,200);*[13] *otherwise 30% above Rwf 1 million (US$ 1,200).* • *Zambia: 10% withholding tax on rent.*[14]	These tax reliefs improve affordability subject to sharing of the subsidy between landlords and tenants. Even if savings are not passed along to tenants via reduced rent, tenants will benefit if landlords utilize the savings for increased maintenance or improvements. Landlords may also utilize the savings towards the acquisition of additional buildings, thus potentially having a beneficial impact on supply.	These rent reliefs address the bottom segments of the rental market which comprise the bulk of the housing stock. The reliefs might incentivize small-scale investors to expand the supply of affordable housing. In Nairobi, for instance, where the basic monthly rent of a single room built of permanent materials is about KES 3,000 (USD 30), a house owner (who currently does not earn rental income) could build an additional four rooms for subletting without attracting additional tax.	• Threshold below which rental income is not subject to personal income tax
Corporate tax relief on rental income and income from unit sales levied on traditional property development or ownership companies • *Kenya*: The corporate tax for private housing developers has been reduced from 30% to 15% as long as they build 100 low cost houses annually.[15] *A similar tax reduction was available for savings and credit cooperatives (SACCOs) with an output of 100 houses per year. No definition of low-cost housing has been given in the law.*	Properly designed reliefs to developers of affordable housing may promote affordability as they may expand supply which would in turn lead to lower rents and prices (in real terms i.e. not in nominal prices). The Kenyan corporate tax relief extended to developers has not worked well because the threshold for eligibility has been set too high and the approval process is cumbersome.	Tax reduces corporate surpluses for land assembly/ acquisition and property development. Lower taxes could lead to increased supply if developers plow savings back into further projects with affordable housing. Even if savings are only retained as corporate profits, they may serve to incentivize more developers to enter the market.	• Price and quantity criteria that qualify developers for corporate tax reliefs; • Quantum of corporate tax reliefs extended to qualifying developers (and associated terms and conditions) • Other tax reliefs related to rental housing.
Corporate Tax: Residential REITs pay no or minimal corporate tax if they distribute a high portion of their profits to investors.[16] • *This relief is only available in Kenya and South Africa. Survey data confirmed that in Kenya, REITs are exempted from corporate tax.* • *Nigeria: Iincome from corporate bonds (and government securities) is deducted ahead of computing income tax.*[17]	Corporate tax reliefs could have a beneficial impact on affordability as they might stimulate supply by enabling REITs to attract more resources from investors (due to increased distributed profits).	Distributing a high proportion of profits reduces REITs' own surpluses for land assembly/ acquisition and development but higher inflows of investor funds might counter this outflow of funds.	• Number and type of REITs in each country • Conditions regarding extent of profit distribution to investors (%) • Level of exemption from corporate tax (%)
Mortgage interest relief granted to individual owner-occupiers • *Cape Verde and Kenya: Tapayers may deduct interest paid on mortgage loans from their taxable income.*[18] • *Kenya: Qualifying mortgage interest deduction raised from KES 150,000 (US$ 1,500) to KES 300,000 (US$ 3,000) per year with effect from January 2017.*[19] *This relief is now also available to those who obtain housing loans from SACCOs, previously not the case.*[20]	Tax relief improves affordability somewhat and thus encourages home ownership. Tax authorities, for instance in Kenya, impose a threshold on the allowable interest deduction to temper its regressivity.	Relief could raise demand for end-user financing (mortgages) and also have a beneficial impact on savings by households.	• Level of tax relief on mortgage loan interest

11. http://www.2merkato.com/articles/tax/1003-rental-income-tax-in-ethiopia. The US$ equivalent is for 2016.
12. PricewaterhouseCoopers (2016) "The Home Stretch --- Kenya's 2016/17 National Budget. PwC Insight and Analysis". See file:///C:/Users/4330s/Downloads/Kenya%202016-17%20National%20Budget%20-%20PwC%20insight%20analysis.pdf
13. Survey data.
14. Survey data.
15. Cytonn Real Estate (2017). "Nairobi Metropolitan Residential Report 2017". See https://www.cytonn.com/uploads/downloads/residential-research-report-vf.pdf
16. REITs are only found in a few countries: one each in Ghana, Kenya (commercial REIT), Morocco (commercial REIT), and Tanzania. Four in Nigeria; 30 in South Africa. (Rebel Group op. cit.)
17. Rebel Group *ibid.*
18. CAHF op. cit.
19. Knight Frank (2016). "Kenya: Market Update – Second Half of 2016".
20. https://saccoreview.co.ke/2017/02/14/big-win-for-sacco-members-in-tax-relief/

Taxes and Tax-Related Reliefs or Subsidies	Potential Impact on Affordable Housing	Possible Implications for the Housing Value and Housing Finance Value Chains	Key Taxation Indicators
Waiver of withholding tax, or other tax relief, on mortgage-backed securities or corporate bonds issued by mortgage liquidity facilities • *Egypt: Tax exemptions for bond holders* [21] • *Nigeria: No withholding tax on mortgage-backed securities alongside bonds and other asset-backed securities*[22]	Access by primary mortgage lenders to more competitively priced term loans from liquidity facilities could enable them to increase loan tenors and reduce their lending interest rates, thus improving affordability for the end-user.	Capital market may expand as funds, such as pension funds, invest in mortgage-backed securities, attracted by higher risk-adjusted returns. The capacity of primary mortgage lenders to expand their mortgage portfolios may increase.	• Level and types of tax relief on corporate bonds issued by mortgage liquidity facilities as well as on mortgage-backed securities

Indirect taxation of housing related goods and services

Indirect taxes

National governments levy indirect taxes on a wide variety of housing-related inputs. These taxes are set as a percentage of value (ad valorem) and they include value added tax (VAT), sales tax and import duty. VAT is a tax on the value added at each stage of production and is "collected in small chunks from each link in the supply chain … VAT charged on sales to registered traders who sell on an item or use it in production can be reclaimed by the purchaser … only VAT on retail sales cannot be reclaimed".[23] In contrast, sales tax is levied on final consumption without "dividing liability across the supply chain"[24]. Import duty, as its name implies, is levied on goods brought into a country by importers. In reference to housing, indirect taxes are typically levied on building materials, plant and equipment, building contracts, professional services and financial transactions.

Tax reliefs

Reliefs are granted by tax authorities to meet a variety of objectives. In some cases they are meant to reduce the costs of inputs such as building materials and thus improve affordability. In other cases, reliefs are granted to help deepen the capital market. In Nigeria, for instance, dividends of publicly-traded REIT units are exempt from sales tax and VAT.

Impacts of indirect taxes

Indirect taxes on housing goods and services raise the cost of housing delivery and thus directly reduce affordability of the final product for the end-user. These taxes could also impact on affordability in other ways. For instance, a tax on building materials imports is likely used as a fiscal tool to stimulate the production of local building materials. However, in the absence of other factors that might support the growth of the building materials industry, this policy has the unintended consequence of making houses more expensive. This is because in a housing market with limited competition, developers can continue to import materials but price for them in their housing. This then puts developer-driven housing out of reach of the majority, who then need to meet their needs individually, likely with poor quality building materials or by purchasing resale homes.

Affordability could also be affected through indirect channels. By raising costs, indirect taxes could lead to lower profitability, and thus result in reduced housing investment and supply. Moreover, in markets with a limited supply of developer finance, higher costs of delivery could also rule out large projects that benefit from economies of scale. This would adversely affect affordability.

Table 3 lists the main indirect taxes on housing and related tax reliefs as well as their potential implications for affordability. As in the previous table, other information is also provided: the possible implications for the housing value and housing finance value chains, country examples of indirect taxation, and the key indicators whose data should be collected for purposes of creating a dashboard.

21. Hassler, O. (2014) "Housing and Real Estate Finance in MENA Countries" in Smith, D. and Freeman, A. (eds.) *Housing Markets and Policy Design in the Gulf Region. Gulf Research Centre Cambridge.* P.105
22.Rebel Group op. *cit.*
23. Mirrlees, J. et al. *op. cit.*
24. Mirrlees *ibid.*

Table 3: Indirect taxes and their impact on affordable housing

Taxes and Tax-Related Reliefs or Subsidies	Potential Impact on Affordable Housing	Possible Implications for the Housing Value and Housing Finance Value Chains	Key Taxation Indicators
Sales tax on building materials, plant and equipment, and securities • *Nigeria: Dividends of publicly traded REIT units exempt from sales tax.*[25]	Adverse impact on low-income self-builders since this is typically a uniform percentage on goods and services procured, irrespective of the income of the buyer. This means that for the same spend on similar building materials, a poor household would pay the same tax as a rich household.	Sales taxes on building materials, plant and equipment raise construction costs. Exemption of REIT units from sales tax, as in Nigeria, could promote trading of units and liquidity.	• Level (%) of sales tax on building materials, plant and equipment, and securities (%) • Available tax waivers
VAT: On property sales, building materials, plant and equipment, professional fees (land surveying, architectural and engineering fees, property management fees), securities. • *Zambia: 16% VAT on home sales. Delays of 6-12 months in getting refunds.*[26] • *Ethiopia: VAT exemption in respect of sale or rent of a dwelling which has been used for 2 years.*[27] • *Ghana: Abolition in 2015 of 5% VAT on property sales; previously 17.5%.* • *South Africa: Government-subsidised housing is exempted from VAT (14%).* • *Kenya: VAT exemption on purchase of REIT units and Asset Backed Securities.*[28] • *Nigeria: Dividends of publicly-traded REIT units exempt from VAT.*[29]	Adverse impact for low-income self-builders since this is typically a uniform percentage on goods and services procured, irrespective of the income of the buyer. This means that for the same spend on similar building materials, a poor household would pay the same tax as a rich household. Significant delays in getting VAT refunds, for instance 6-12 months for property sales in Zambia, bound to increase developer costs and undermine affordability. VAT reduction on property sales in Ghana was the result of strong lobbying from real estate developers but in spite of the introduction of this tax rebate in October 2015, concerns have been expressed about the slow growth of the real estate sector.[30] In South Africa, the exemption from VAT of government-subsidized housing had the unintended consequence of making privately delivered and financed housing 14% more expensive by comparison.	Tax raises the costs of land titling and design/supervision and property management, if levied on professional services; also raises the costs of construction. Abolition of VAT on property sales, as in Ghana, could promote sales and liquidity. Exemption of securities from VAT, as in Kenya and Nigeria, could promote trading of securities and liquidity.	• Level (%) of VAT on property sales building materials, plant and equipment, professional fees, and securities (%); • Available tax waivers
Import duty on building materials, plant and equipment • *Democratic Republic of the Congo: Lifted import taxes on cement.*[31] • *Malawi: Over the last 5 years, import duties on housing inputs reduced by more than 20% of import duty of 20%.*[32] • *Ethiopia: Import duty on housing inputs increased by 3% over the last 5 years.*[33] • *Rwanda: No tax on raw materials, 10% on intermediate materials, and 25% on finished materials.*[34] • *Zambia: Import duties are very high, at 25%, for building materials imported from outside Southern African Development Community; and duty has increased by 5% over the last 5 years.*[35]	Adverse impact for low-income builders since this tax raises the cost of construction. In DRC, lifting of import taxes on cement has reduced the price of cement although it has remained high because of limited supply. [36] In Malawi, reduction in import duty has led to beneficial impact on affordability.	Import duty raises the cost of house construction, maintenance and improvements. But import duty has also been used, although with mixed results, to stimulate local materials production. Affordability improves if this policy succeeds and prices for local building materials fall as a result.	• Level (%) of import duty on building materials, plant and equipment

25. Rebel Group *op. cit.*
26. Survey data.
27. http://www.ethiopianlaw.com/blog/181-vat-exempted-items-in-ethiopia Information is for 2010.
28. PwC (2017)
29. Rebel Group *op. cit.*
30. PwC (2017) *op cit.*
31. CAHF *op. cit.*
32. Survey data.
33. Survey data.
34. Survey data.
35. Survey data.
36 CAHF *op. cit*

Taxation of housing wealth

Property taxes

Taxes on property are defined as those "payable on the use, ownership, or transfer of wealth".[37] Owners of housing and other types of real estate pay property taxes which are more often than not levied by sub-national governments. The two broad tax categories are:

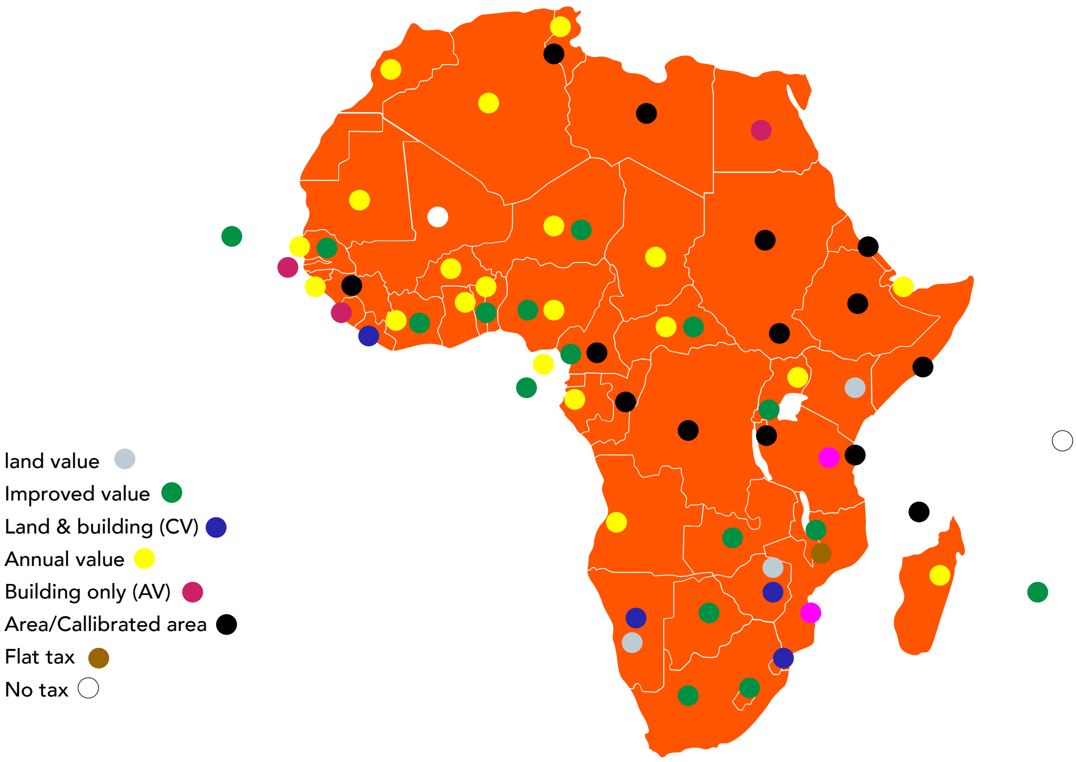
- Recurrent taxes based on the value of immovable property whether land or buildings or both; and
- Non-recurrent taxes that are levied upon property sale, gifting or inheritance (including stamp duty, capital gains tax, gift taxes, and death and inheritance taxes).

In view of their complexity, it is useful to describe the respective tax bases for recurrent property taxation. The main bases distinguished in Franzsen and McCluskey (2017, 6) are:

- An area-based tax which is used where insufficient market data exists to implement a value-based system. This tax can be applied to land only as a rate per unit of area, or to buildings only whereby the area metric is a unit of floor area.
- A value-based tax, with value classified into the following categories:
  - Annual value or annual rental value of improvements, whereby the taxable value is based on the estimated annual rental value of the property.
  - Unimproved value, where the tax base is the land only. Other terms used are site value or land value taxation.
  - Capital improved value which is the market value of a property, that is, the value of land plus all improvements as a single tax object.
  - Other variants where the tax is based either solely on the improved value of buildings or on the separate values of land and improvements.

Property taxation is found in all African countries with the exception of Burkina Faso and Seychelles, and in some countries, it is provided for in the constitution as a source of revenue for sub-national governments.[38] Figure 1 illustrates the property tax systems on the continent while the taxes and their implications for affordable housing are set out in Table 4.

Figure 1: Property Tax Systems in Africa



Source: McCluskey, W. J. and Franzsen, R. C. D. (2014)

37. IMF (2014) Government Statistics Manual. Washington, DC. Cited in Franzsen, R. and McCluskey, W. *op. cit.*
38. Franzsen, R. and McCluskey, W. *op. cit.*

Not included in Figure 1, are taxes based on unearned increases in private land value stemming from public financing of off-site infrastructure. The unearned capital gain can be captured indirectly by means of real estate taxes. This is a way of internalizing the positive externalities of public investments and redirecting the revenue generated towards public services and amenities. Franzsen and McCluskey (2017, 565) observe that "it may be some time before most African countries can absorb this approach, primarily because new land legislation or amendments of existing laws will be required before this approach can be implemented".[39] Still, there are examples in African cities of financing of residential infrastructure based on land-value capture although it has not been systematic.[40]

Tax reliefs

To promote affordability, Franzsen and McCluskey (2017, 17) point out that "African countries provide extensive tax holidays for newly developed or renovated residential properties". They add that reliefs vary in length: five to 10 years in Angola; five years in Benin if the property is not used for commercial purposes; five years in Equatorial Guinea, Madagascar and Morocco; three years in Gabon; and two years in Niger.

An additional policy is to waive taxation for residential properties whose value falls below a defined threshold. Countries with such a threshold include Egypt, Morocco and South Africa. On the whole, these commentators conclude that these tax reliefs have not been effective in boosting housing supply[41] but may well be effective in increasing housing affordability for the occupiers/owners.

Cape Town, alongside other South African cities, uses a tax rebate, the Urban Development Zoning (UDZ) tax, to stimulate private re-development of central city areas that have fallen into neglect. Improvements of existing buildings as well as building extensions and additions qualify for this tax rebate. The rebate was introduced in 2003 and is available to both small and large developers of residential and commercial property in designated central city sites. A new residential unit, added to an existing dwelling, would qualify for a 25% (of cost) deduction during the first year, 13% during years 2-6, and 10% in the seventh year. Improvements to a low-cost dwelling would enjoy a deduction of 25% over four years.[42] Alongside other objectives, this tax seeks to expand affordable rental accommodation within the city centre. A 2008 assessment of the UDZ tax rebate indicated that in spite of a slow start, the rebate had a beneficial impact in several South African cities.[43]

Kenya and South Africa offer two contrasting examples of property taxation and available tax reliefs in Anglophone Africa (Box 1). In Kenya, there is no differential taxation of residential properties meaning that housing, and low-cost housing in particular, is not favoured in any way. Property rates are similar for both residential properties and commercial and industrial properties. South Africa takes a more differentiated approach that provides low-priced housing with several tax reliefs.

Box 1: Two contrasting examples of taxation of residential property

Kenya

The main urban property tax, referred to as the property rate, is based on the unimproved market value of land, although area-based taxation also exists on a limited basis. These taxes are levied by county governments which are devolved administrations with the constitutional mandate to set local taxes within legal frameworks agreed with the national government. A uniform tax rate is used for all urban property which is a departure from the previous practice of making a distinction between types of property. In the 1980s, residential property rates were less than a half of those levied on commercial and industrial properties but by 1997, these taxes had converged.[44] This means that residential property, including affordable housing, does not receive preferential treatment. The uniform tax rate in 2015 was 25% of the unimproved value, although in future this rate could vary across counties if these governments decide to exercise greater autonomy in setting local taxes.[45]

Other property-related taxes include the stamp duty, a tax paid by the purchaser upon property transfer, and the capital gains tax (CGT). The stamp duty is 4% of the market value of urban properties (2% for rural properties) and there is no preferential treatment for residential properties nor is there a differential rate based on property value. The capital gains tax is equivalent to 5% of the gain with no distinction between residential and non-residential properties. This tax is waived where the transfer is between family members or between a wholly-owned family company and a family member.[46]

39.In some developed countries, for instance the United Kingdom, attempts to introduce these taxes have ended in failure "in large parts as a result of lack of credibility over the long term sustainability of the tax" Mirrlees J. et al., (2011). The tax has been quite successful in some countries in Latin America --see Smolka, M. O. (2013) "Implementing Value Capture in Latin America: Policies and Tools for Urban Development". Policy Focus Report. Cambridge MA: Lincoln Institute of Land Policy.
40.Centre for Affordable Housing Finance in Africa (2016). "Financing Infrastructure for Housing Developments: Case Studies from Sub-Saharan Africa". http://housingfinanceafrica.org/app/uploads/CAHF-Case-Study-4_Infrastructure-Financing.pdf
41. Franzsen and McCluskey op. cit. (p. 60) say they could find no evidence of tax reliefs stimulating housing supply presumably because of the low level of property taxes.
42. Cape Town Partnership (2014) "How to Make the UDZ Work for You". See: https://www.capetownpartnership.co.za/2014/09/how-to-make-the-udz-work-for-you/
43. Report on the proceedings of the Well-governed Cities Seminar on the Urban Development Zone tax incentive, Durban International Convention Centre, 25 January 2008. See: http://www.sacities.net/wp-content/uploads/2014/09/report.pdf
44. Residential property taxes had been raised at a higher rate during the intervening period. See Franzsen, R. and McCluskey, W. op. cit. p. 238.
45. Such taxes would not include the direct and indirect taxes discussed in this paper as these are the preserve of the national government.
46. See https://www.lexology.com/library/detail.aspx?g=342743f4-c8a1-48de-99e3-1b2c4bb4314b

South Africa

The property tax, referred to as "rates on property", is governed by a national law that provides for a uniform framework for the whole country. Taxes are determined annually by each municipality. Differential rates are allowed for certain categories or types of property (e.g. vacant), with the law seeking to ensure transparency in the reliefs granted. The main relief for housing is a minimum exclusion from tax of the first ZAR 15,000 (US$ 1,124) of the value of a property used for residential purposes – municipalities have the power to increase this, however. Most of the larger cities have set the tax threshold closer to R200 000 (US$ 14,990). Notably, most government-subsidised housing would fall above the mandated minimum threshold but below the higher threshold set by most major cities.

There are several other property-related taxes. Value Added Tax (VAT) is levied at the rate of 15% on the sale of properties by VAT-registered developers. A transfer duty is paid by the buyer upon the acquisition of property but purchases that attract VAT are exempted from this tax, as is the inheritance of property from a deceased person. A transfer duty is also due upon the conversion of usufruct rights (rights of use of land) to full ownership of land. The acquisition of shares in a private company or a contingent right in a trust owning primarily residential property is taxed as if the property itself has been transferred.[47] The transfer duty is levied on a differential basis and properties with a value below ZAR 900,000 (US$ 67,470) do not attract a transfer duty. This practice seeks to promote affordability.

Another tax is the capital gains tax. A low-valued residential property serving as the primary residence of the tax payer attracts no CGT if its value is lower than ZAR 2 million (US$ 149,925). This exemption aims to improve affordability. For higher priced properties, there is an exemption from CGT of ZAR 2 million (US$ 119,925). There is an annual deduction of ZAR 40,000 from the capital gain and the remainder is multiplied by 40% to arrive at the amount to be included in the tax payer's income.

Yet other taxes are estate duty and a donations tax payable when property is transferred by succession or donation. With regard to property donations, the donor pays tax at the rate of 20% of the market value of the property while the donee pays transfer duty, also based on the market value.

Impacts of property taxes

Property taxes tend to raise house prices and rents and thus have an adverse impact on affordability. By raising prices for land, these taxes can adversely affect investment in housing. There are other impacts as well. Property taxes influence locational choices by developers and households who, for instance, might opt for land parcels just outside city boundaries, if these are charged lower property taxes or are exempted altogether. High transfer taxes, in particular, discourage land transactions and the development of land markets. By impinging on movement up the housing ladder, transfer fees block filtering and thus may contribute to limited supply at the lower end of the market, thus negatively impacting upon affordable housing. This type of tax also suppresses house trading, especially for lower-income households who have limited access to loans and who thus find it difficult to meet the cost of the tax. In this way, mobility within the housing market is reduced.

Table 4 lists the main property taxes, related tax reliefs and their potential implications for affordability. The other information provided includes: the possible implications for the housing value chain and housing finance value chains; country examples of property taxation; and the key indicators whose data should be collected for purposes of creating a dashboard.

Table 4: Property taxes and their impact on affordable housing

Taxes and Tax-Related Reliefs or Subsidies[48]	Potential Impact on Affordable Housing	Possible Implications for the Housing Value and Housing Finance Value Chains	Key Taxation Indicators
Area-based property tax • *Burundi, Democratic Republic of Congo, Sudan, Tanzania*[49] • *South Africa: Special Rating Areas*	Tax is regressive if it charges the same amount for all properties that are the same size. But this tax is commonly adjusted for such attributes as location and use, making it more equitable. In Dar es Salaam, adjustments are made for land use, size and location.[50]	Land assembly: Tax could influence locational choices by developers, property buyers and tenants.	• For principal cities, property tax as a proportion of the value of the minimum priced formal house • Tax waivers for affordable housing • Policies/legislation allowing for special rating of geographic areas
Property tax based on annual rental value of improvements • *Algeria, Cote d'Ivoire, Egypt, Ghana, Sierra Leone, Mali, Mauritania, Morocco, Niger and Uganda*	Tax is progressive since owners of property are generally in higher income bands.[51] However if landlords shift the burden of the property tax onto tenants via increased rent, the impact on affordable housing is negative.	Land assembly: tax could influence locational choices by developers.	• For principal cities, property tax as a proportion of the value of the median or minimum priced rental unit

47. This seems to suggest that residential property is penalized vis a vis non-residential real estate.
48. The property tax information in this column is based on Franzsen and McCluskey *op. cit.*
49. Some towns in Tanzania also use a value-based taxation in addition.
50. Franzsen and McCluskey *op. cit.* p. 7.
51. Property tax authorities (mainly sub-national governments) are supposed to use property tax revenues to finance local services such as road repairs, street lighting and solid waste collection. For owner-occupied housing, the owners bear the burden of the tax to the extent that they do not get value-for-money. The same principle applies to tenants -- they bear the burden of the tax only if the tax shifted to them through higher rents is not equivalent to the value of the local services they enjoy. Because a property tax is generally tied to the services it finances it is often referred to as a benefit tax.

Taxes and Tax-Related Reliefs or Subsidies	Potential Impact on Affordable Housing	Possible Implications for the Housing Value and Housing Finance Value Chains	Key Taxation Indicators
Property tax based on unimproved land value • *Kenya, Namibia, Central African Republic, Cote d'Ivoire*	Tax is progressive since owner-occupiers of housing are generally in higher income bands. Higher tax rates on vacant land can be used to densify urban areas, encourage development and increase the supply of housing, by raising the costs of land-holding to such an extent that land owners are pushed to develop or sell.	Land assembly: Tax could influence locational choices by developers.	• For principal cities, tax as a proportion of the value of the minimum priced formal house • Property tax rates for vacant land and associated conditions
Property tax based on capital improved value i.e. capital value of land and improvements • *South Africa: Some municipalities allow exemptions for vulnerable groups, based on means testing. Also rebates may be provided to residential sectional-title property owners in order to encourage higher density settlements.* • *Angola: Eliminated property tax for low-cost housing through legislation.*[52]	Tax is progressive since owner-occupiers of housing are generally in higher income bands.	Land assembly: Tax could influence locational choices by developers.	• For principal cities, tax as a proportion of the value of the minimum priced formal house • Thresholds for tax exemption for residential properties • Rebates or differential rates policies for specific geographical areas or categories
Property tax based on improvement value of buildings only(land not included) • *Ghana, Mozambique and Tanzania*	Tax is progressive since owner-occupiers of housing are generally in higher income bands.	Tax could influence locational choice by developers, buyers and tenants.	• For principal cities, tax as a proportion of the value of the minimum priced formal house • Tax waivers for affordable housing
Property tax based on separate value of land and improvements • *Namibia, Swaziland*	Tax is progressive since owner-occupiers of housing are generally in higher income bands.	Land assembly: Tax could influence locational choices by developers.	• For principal cities, tax as a proportion of the value of the minimum priced formal house • Tax waivers for affordable housing
Capital gains tax (on sale of property or mortgage-backed securities) • *Kenya: 5% tax on capital gain; but this tax is waived where the transfer is between family members or between a wholly-owned family company and a family member.* • *In South Africa, no CGT if property value of primary residence is lower than ZAR 2 million (US$ 152,010). For higher priced properties, there is an exemption from CGT of ZAR 2 million (US$ 152,010)*[53]	Likely to be progressive since house owners/ investors tend to be in higher income groups. Exemption of CGT improves affordability.	N/A	• Level of capital gains tax (% of capital value increment) • Terms and conditions for exemptions from capital gains tax • Tax waivers for affordable housing

52. CAHF *ibid.*
53. Franzsen and McCluskey *op cit.*

Taxes and Tax-Related Reliefs or Subsidies	Potential Impact on Affordable Housing	Possible Implications for the Housing Value and Housing Finance Value Chains	Key Taxation Indicators
Property Transfer Taxes[54] • *Anglophone Africa: Ranges from 1% in Uganda to as high as 10% in Lesotho and a maximum of 13% in South Africa, where a sliding scale is used.* • *Francophone Africa: 3% in Burundi, 5 % in Guinea, 6% in Togo, and 7% in Mali.*[55] • *Ethiopia: Stamp duty at 2% of property value and ownership title transfer tax at 4% of property value.*[56] • *Chad, Republic of Congo: These countries have reduced their property transfer tax.*[57] • *Gabon: Zero taxation of asset transfers.*[58] • *South Africa: Property purchases that attract VAT are exempt from transfer tax.*	Adverse impact on affordability if transfer tax is high and the closing costs of the transferee are not financed. May be regressive if differential rates not applied based on property value. There is abuse of this tax in many jurisdictions, for instance, underreporting of price. The tax also discourages house trading and thus reduces mobility within the housing market.	Negative implications if en-user financing for transferee does not cover closing costs.	• Level of stamp duty or transfer fees (% of property value) • Exemptions from transfer taxes or concessions • Tax waivers for affordable housing
Estate/ inheritance taxes • Ethiopia: No estate duty or other death duties;.[59] • Kenya: No inheritance/ estate tax for individuals.[60]	N/A	For low-income households, estate or inheritance taxes may render formal transfer unaffordable, thus discouraging, or delaying, the acquisition of the title deed. This may lead to informal or irregular arrangements which do not allow beneficiaries to leverage the inherited property as financial asset (e.g. collateral for a loan) or to formally sell.	• Level of estate and inheritance taxes; • Tax waivers for affordable housing.

Tax Evaluation and Reform

The main criteria for evaluating taxation systems were set out in Section 2. In practice, the outcomes of such an evaluation will vary across countries in view of the differences in taxation systems and their implementation. Moreover, while the criteria apply to the entire breadth of the tax system, it is reasonable to expect that for all countries, features unique to each market segment might also influence outcomes. For example, the administrative efficiency of collecting rental income and property taxes will differ widely across countries depending on the degree of informality of housing markets. This is because informal housing markets, by definition, are poorly documented and regulated, making them difficult to tax.

Box 2 illustrates the outcomes of an evaluation of direct and indirect taxes in South Africa, pointing to the underlying strengths and weaknesses. Similar evaluations for other countries would yield different results. South Africa has deliberately used taxation, alongside social spending, to promote equity and the progressiveness of its taxes may thus be atypical.[61]

54. Levied as a transfer tax in some countries and as stamp duty in others. In yet other cases both taxes are levied -- see Franzsen and McCluskey *ibid.*
55. Franzsen and McCluskey *ibid.*
56. World Bank Doing Business website: http://www.doingbusiness.org/data/exploreeconomies/ethiopia/registering-property
57. CAHF (2016) *op. cit.*
58 CAHF *ibid.*
59. http://ethiopianlaw.com/blog/164-the-direct-and-indirect-taxes-applicable-in-ethiopia. This information is for 2013.
60. https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-kenyahighlights-2017.pdf?nc=1
61. Inchauste, G. et al. (2015) "The distributional impact of fiscal policy in South Africa." Policy Research Working Paper Series No. 7194. Washington D.C.: The World Bank. Available at: http://documents.worldbank.org/curated/en/502441468299632287/The-distributionalimpact-of-fiscal-policy-in-South-Africa

Box 2: An evaluation of direct and indirect taxes in South Africa

- Personal income tax is efficient and certain, and equity is enhanced by capital gains tax. This tax is progressive by design.
- Corporate income tax is not economically efficient, particularly in the case of incentive programmes. It is unclear how the burden is shared among shareholders, institutional investors and consumers. The tax is complex and open to interpretation, and responds strongly to the business cycle.
- VAT is efficient, mildly progressive, transparent, certain and buoyant. Any increases should be accompanied by an assessment of compensating mechanisms to address negative impacts on low-income households. The single standard rate should be retained and no further zero ratings should be considered.
- Customs duties are relatively efficient, somewhat progressive, quite transparent and buoyant.

Source: Adapted from Davis Tax Committee (2015).

An evaluation of property taxes is found in Franzsen and McCluskey (2011). This form of taxation is attractive to local governments because the tax base, real property, is visible and immovable. Other advantages for the taxing authority are: revenue income increases as property values grow over time; the tax is potentially progressive because its burden falls largely on property owners who tend to have higher incomes; and if the tax is well-administered and finances local services, payers will consider it fair, directly linking tax payment to the services provided. In practice, there is much evasion of property tax payment in Africa as a result of poor information on ownership of property and the limited collection capacity of local governments. Moreover, where cadastres are out of date, a common feature, the tax liability on properties is typically not in line with current property values.[62] For these reasons, the effectiveness of property tax reliefs in stimulating new housing supply is doubtful. At the same time, the potential of tax reliefs to improve affordability is undermined by the limited ownership of property by lower-income households.

In evaluating property taxes, it is useful to compare property taxation of affordable housing with the taxation of non-residential real estate (commercial and industrial property). The aim is to establish if there is tax neutrality between these two types of real estate. In other words, are the different types of property treated equally or differently? In Kenya, the Income Tax Act shows that hotel buildings and buildings used to host manufacturing activities are eligible to an investment deduction of 100 percent if the investment is in one of the three principal cities.[63] Elsewhere in the country, the investment deduction is 150 percent.[64] In both cases, the investment cost must be at least equal to KES 200 million (US$ 2million). Some countries included in a small survey for this study reported no preferential tax treatment for developers of commercial and industrial property.[65] These were Rwanda, South Africa, Uganda, and Zambia. Only for Ethiopia and Malawi was preferential treatment reported, consisting of lower corporate tax in Malawi.

In Tanzania, property taxes for affordable housing are lower than on commercial and industrial real estate.[66] Similarly, in Benin, residential property gets more favourable treatment in that there is a ten-year exemption for new buildings or improvements as long as they are used as residential dwellings and are built on titled land. This period is reduced to five years if the land has no title.[67] The preferential treatment of residential property, especially for low-value buildings used as the primary dwelling by the owner, is quite widespread as pointed out in country cases in Franzsen and McCluskey (2017) and is also consistent with international practice.[68] This preferential treatment seeks to improve affordability and social equity.

In jurisdictions where commercial and industrial property are accorded preferential treatment, the underlying argument seems to be the one advanced in economics literature i.e. on efficiency grounds, capital goods used as inputs in the production chain merit low or no taxation.[69] The same argument could be extended to low-income housing in developing countries as it often accommodates home-based enterprises that play an important role in production activities.

Tax reforms that seek to improve the impact of tax instruments on affordable housing must be understood in a wider context of the taxation system. These considerations include: the tax revenue to GDP ratio, relative revenue outcomes of different tax instruments, and the impact of the informal economy.

62. To compensate for this, local governments increase the rates charged i.e. the rate struck, year-on-year within limits set by the national government.
63. This is a deduction allowed against profits, on capital expenditure for buildings for purposes of manufacture and certain hotels.
64. Deloitte (2017) "International Tax: Kenya Highlights 2017". See: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-kenyahighlights-2017.pdf?nc=1
65. See footnote 2.
66. Franzsen and McCluskey op. cit.
67. Tayoh, B. and McCluskey, W. (2017). Benin. In: Franzsen and McCluskey ibid. pp 107-120.
68. See, for instance, Bird, R. M. and Slack, E. (2004) **International Handbook of Land and Property Taxation.** Edward Elgar: Cheltenham, UK and Northampton, MA, USA.
69. See, for instance, Mirrlees, J. et al. *op. cit.*

- **Ratio of tax revenue to GDP:** Any proposed reform which seeks to lower taxes in order to reduce housing costs will need to take account of the ratio of tax revenue to the gross domestic product (GDP). This is an important consideration since Africa needs to raise its tax revenue-to-GDP ratio which is low, at 18 percent,[70] compared to the average of approximately 25 percent for OECD countries.[71] Policies that aim to reduce housing taxes without substantially increasing housing supply and thus expanding the tax base, will likely not be supported by fiscal authorities. Moreover, since the tax revenue-to-GDP ratio varies so widely, from 28 percent in Lesotho to 5 percent in Nigeria,[72] it is reasonable to assume that the potency of tax as a policy tool also varies from country to country.

- **Comparative revenue potential of various tax instruments:** Tax reforms aimed at improving housing affordability will also need to take account of the wide variation in the relative size, by revenue outcome, of different taxes in each country. For instance, while VAT's share of GDP is higher than 10 percent in some countries (Lesotho, Senegal, and South Africa), it is a mere 1 percent in Nigeria.[73] It is thus reasonable to assume that VAT would be a more effective fiscal tool in these high VAT countries than in Nigeria. The nature of a tax, irrespective of its importance as a revenue source, also matters. Stamp duty is a good example since it is a relatively minor source of revenue but with important implications for housing market transactions. This tax is paid upon the transfer of real property and acts as a significant financial burden, especially for low-income households because of their limited savings and poor access to loans. As a result, it reduces mobility within the housing market. There is therefore a good case for exempting affordable housing from this type of tax as in South Africa where properties with a value below ZAR 900,000 (US$ 67,470) do not attract a transfer tax.

- **Degree of informality in the economy:** Households and small enterprises in the informal sector are inherently difficult to tax. Countries with a large informal sector, whose output is typically not reflected in GDP, also tend to have a low per capita income. For the sample of 21 African Tax Outlook (ATO) countries evidence shows that, on the whole, those with a high GDP per capita also have a high tax revenue per capita. In the richer countries, therefore, taxation can be used more effectively to influence the housing market than in poorer jurisdictions.

Returning to the criteria for evaluating taxation systems set out in section 2, it is clear that efforts to reform the tax system in order to enhance housing affordability should focus on rectifying the main shortfalls evident in the current instruments: potential negative unintended consequences; inefficiency; and poor design.

Taxes with unintended consequences

There are taxes that do not accord similar treatment to similar economic activities, resulting in negative unintended consequences. These taxes are not neutral and they create perverse incentives that could undermine investments that would otherwise be desirable. South Africa is a case in point. Government-subsidised housing is exempted from VAT (15 percent) and while this, in principle, is an effective way of redistribution, it has the unintended consequence of making privately delivered and financed housing more expensive by comparison. A tax neutrality argument would thus suggest that all affordable housing be exempted from VAT. However, there is a real possibility that this benefit directly enjoyed by the developer would not be passed on to the buyer. Yet it can also be argued that, even if the savings is not passed along to the buyer, the elimination of VAT for all affordable housing could lead to an increase in supply because it serves to provide developers with a financial incentive to enter the affordable housing market.

Another example, drawn from Kenya, is that property rates have lost their neutrality (Box 1). Residential property rates in the 1980s were less than a half of those levied on commercial and industrial properties but, by 1997, these taxes had converged. In effect, this means that residential property, including affordable housing, has lost out over the years relative to these other types of real estate. In contrast, property rates for residential property are lower in South Africa than for commercial and industrial property. These examples suggest that non-neutral taxes may serve to support affordable housing, but negative unintended consequences with regard to the behavior and investment decisions of market players must also be considered.

Taxes with high compliance costs

The African Tax Outlook (ATO) argues that lowering VAT thresholds to broaden the tax base, might actually reduce VAT revenue. This is because the cost of ensuring compliance with this tax by firms with a small annual turnover would likely be higher than the revenue collected. There would be additional economic costs as well since businesses that previously fell outside this tax net would incur VAT-related administrative costs. The ATO adds that on these grounds, many developing countries have raised their VAT thresholds. In the circumstance, there seems to be a good case for exempting small-scale producers of affordable housing from VAT.

70. This is the average for the 21 countries in the African Tax Administration Forum: Botswana, Benin, Burundi, Cameroon, Gambia, Kenya, Lesotho, Liberia, Mauritius, Mozambique, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Swaziland, Tanzania, Togo, Uganda, Zambia, and Zimbabwe. The average masks wide variations in country ratios, for instance 28% in Lesotho, but only 5% in Nigeria. Source: African Tax Outlook 2017. See: https://www.ataftax.org/en/component/jdownloads/send/30-ato-publications/30-2nd-publication-english-2017?option=com_jdownloads
71. Organization for Economic Cooperation and Development.
72. Data are for 2015. The low figure for Nigeria is explained by several factors: only federal taxes have been taken into account; historically, the country has had high non-tax revenue from oil and has, therefore been able to keep tax rates low; recently, tax revenue has been impacted by political and economic constraints.
73. African Tax Outlook 2017.

Poorly designed taxes

Poorly designed taxes can also negatively impact on housing affordability. A good example is the corporate tax rebate offered to housing developers in Kenya whereby a private developer who builds at least 100 affordable residential units in a year qualifies for a reduction of corporate tax from 30% to 15% (Table 1). This requirement was initially set at 1,000 units but was later reduced to 400 units. This tax relief is considered impractical by developers and is not working well. Indeed, there are only a few developers with the capacity to meet the required output per year. Secondly, the relief has a long approval path which includes the consent of the cabinet secretary responsible for housing.[74] It is not surprising that developers have found the approval process cumbersome.[75] An interview with a large developer confirmed that this relief had not been effective and only one developer appears to have applied for it several years since its introduction.[76] Finally, no definition of "affordable housing" has been provided by the authorities, an omission which is likely to hinder the processing of applications by developers for this tax relief. The difficulties surrounding the implementation of this relief point to the lack of adequate stakeholder consultation prior to its introduction, thus leading to poor design which hinders the achievement of the objectives of the tax instrument.

Conclusion

This paper sought to: (a) develop a housing taxation framework and a taxonomy of housing taxes in order to understand taxation and where it arises in the overall housing value chain and housing finance value chains; (b) identify how the current taxation regimes in different African countries impact on housing affordability, with regard to several aspects of housing: its delivery, its trade and financing, the investment it is able to attract, and ultimately, its cost; and (c) identify the type of data that should be collected on an ongoing basis that would be useful on a dashboard to support the information needs of housing investors.

The paper began with an examination of the purpose of taxation in an economy and the criteria used to assess tax systems. It then proposed a taxonomy based on the broad classification of taxes in public finance. This formed the basis for setting out taxes and related reliefs in three broad categories: direct taxation of housing-related income (taxation of both corporate profits and personal income); indirect taxation of housing-related goods and services consumed by both firms and households; and taxation of wealth held in the form of real estate, commonly referred to as property taxes or property rates. In each case, information was provided, including many country examples, on a wide variety of housing taxes and reliefs to illustrate their likely impact on housing investment, cost and affordability. In addition, the implications for the housing value and housing finance value chains were flagged.

Using the taxation evaluation criteria already set out, the paper presented an assessment of direct and indirect taxes, pointing out that there is a dearth of country-specific reviews of taxation systems. In contrast, there is enough information to show that property taxes are generally progressive besides being valuable sources of revenue for local governments. Their effectiveness in promoting affordability is currently handicapped by poor tax administration by sub-national governments, itself the result of limited institutional capacity.

Tax reform efforts aimed at enhancing the affordability of housing for poor households must chiefly be concerned with rectifying key pitfalls of the current tax instruments, namely potentially negative unintended consequences, inefficiency and poor design. Data from a small survey carried out for the study provided evidence of developers having lobbied fiscal authorities, inviting them to reduce housing taxes - especially import duty and VAT on construction materials, capital gains tax, and stamp duty. The outcomes of lobbying, although judged on the basis of a small sample, were mixed suggesting that ministries of finance have generally been reluctant to grant tax reliefs. that the implication is that tax reform efforts to improve housing affordability will need to meet fundamental requirements in order to gain traction: (a) the economic and social benefits of granting tax reliefs to affordable housing must outweigh the revenue forgone by government; (b) the proposed reforms must support equity; (c) the reliefs sought should promote tax neutrality which requires that similar economic activities be treated in similar ways; and (d) the proposed reforms are simple and easy to administer so that they do not entail high compliance costs.

74. Deloitte (2017). "International Tax: Kenya Highlights 2017". See: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-kenyahighlights-2017.pdf?nc=1
75. PwC has opined that other tax rebates might have been more practical, such as construction-related VAT. See PwC *op cit.*
76. Telephone interview on 2nd October, 2017.

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Abbreviations and Acronyms

CGT	Capital gains tax
DRC	Democratic Republic of the Congo
GDP	Gross Domestic Product
KES	Kenyan shilling
MENA	Middle East and North Africa
N/A	Not applicable
OECD	Organization for Economic Cooperation and Development
PwC	PricewaterhouseCoopers
REIT	Real Estate Investment Trust
Rwf	Rwandan franc
SACCOs	Savings and credit cooperative societies
UDZ	Urban development Zone
VAT	Value-added tax
ZAR	South Africa Rand

Centre for Affordable Housing Finance in Africa

About The Centre for Affordable Housing Finance in Africa (CAHF)

The Centre for Affordable Housing Finance in Africa (CAHF) is a not-for-profit company with a vision for an enabled affordable housing finance system in countries throughout Africa, where governments, business, and advocates work together to provide a wide range of housing options accessible to all. CAHF's mission is to make Africa's housing finance markets work, with special attention on access to housing finance for the poor. We pursue this mission through the dissemination of research and market intelligence, supporting cross-sector collaborations and a marketbased approach. The overall goal of our work is to see an increase of investment in affordable housing and housing finance throughout Africa: more players and better products, with a specific focus on the poor.

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