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Central-Local Government Roles and Relationships in Property Taxation

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Introduction

Should central or local governments be responsible for collection and administration of property taxes? There is great variation in practice across the continent, but one particularly significant divide is that between francophone and anglophone countries. The former commonly adopt centralised systems, while the latter usually decentralise key aspects of property taxation such as collection and administration. This divide has its roots in different modalities of colonial rule, but was exaggerated through the trend towards decentralised governance that took hold in the 1990s, supported by Anglo-American development assistance.

However, a number of anglophone African countries have attempted to partially reverse fiscal decentralisation since the late 2000s, particularly with respect to collection of the tax. International debate is increasing about which level of government should tax property, but currently there is little by way of an evidence base on the relative benefits of each approach.

This policy brief explores some of the strengths and weaknesses of decentralised versus centralised approaches, the incentives they create for government authorities to collect the tax, and some of the political challenges of rearranging central-local relations. It suggests that the question of whether to centralise or decentralise the tax as a whole oversimplifies the problem. Property taxation is made up of a number of distinct processes, some of which may be better situated at national or local government level depending on the context. Before disaggregating property taxation into its key constituent elements, some common general arguments for taxing property at a local versus central level are considered.

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Why decentralise?

A wave of fiscal decentralisation swept across developing countries in recent decades, particularly in the anglophone world. This was predicated on a widespread belief that genuine devolution depends on the decentralisation of certain taxes, because increased local political autonomy is only possible if local authorities administer, and are made to account for, their own resources.

The decentralisation of taxation is therefore intimately linked to efforts to build accountability between citizens and local authorities, and, in doing so, to improve local service provision.[1] However, not all taxes are suitable for decentralising to local governments. Taxes that are considered especially suitable include user fees for services, local business licences and taxes on immobile assets. The latter are suitable for taxing locally because, unlike firms, they are not easily shifted between localities to escape any increase in local rates. Real estate is the ultimate immobile asset, making the recurrent property tax particularly well-suited to local control.

More specifically, the theoretical case for decentralising property taxes can be made on the following grounds:

- There is an obvious link between property and basic local services (such as drainage, waste collection, water and sanitation infrastructure, and local roads), so it makes sense if resources for these local services are collected locally from properties benefitting from them.
- Local administration of property taxes can help to build accountability between local governments providing services and the population using these services.

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- Local authorities are sometimes thought to be more knowledgeable about new properties being built and who actually owns them, and therefore better placed to develop property cadastres and implement taxes on property.
- Incentives are better aligned with responsibilities if property tax is collected locally: local authorities will be more committed collectors of the tax if it comes directly into their accounts, rather than going to a central government agency for redistribution.
- Where there is political decentralisation and opposition parties control local authorities, collecting their own property taxes helps local authorities to protect themselves from the possibility of being starved of funds by central government.

Despite these arguments in favour of decentralisation, most countries with decentralised systems are not collecting anywhere near their potential in property taxation. A number of anglophone countries (particularly in Eastern Africa) have radically recentralised key aspects of property taxation in recent years in the hope of collecting more.

[1] Prichard, W. (2017) *Linking Property Tax Revenue and Public Services*, ICTD Summary Brief 13, Brighton: IDS.

Why centralise?

For many countries, centralised property taxation was not so much a policy decision as a colonial inheritance. Nevertheless, the potential benefits of centralisation merit close scrutiny, given recent decisions to centralise the collection of property tax in countries such as Rwanda, Tanzania and the Gambia, as well as a more comprehensive centralisation of the property tax system at the federal state level in Lagos, Nigeria. The case for centralisation rests on the following points which, again, are theoretical rather than necessarily reflecting the reality in practice:

- National tax agencies may have much greater technical capacity to collect taxes than local authorities, particularly given widespread efforts over the last two decades to develop strong semi-autonomous revenue agencies, usually with donor support.
- Corruption and misuse of funds are often perceived to be easier to identify, prohibit and punish at the national level.
- Central tax agencies already hold significant amounts of data on certain kinds of taxpayers that could be used to help implement property taxation.
- Central tax agencies are perceived to carry more political weight, so may be better able to enforce payment, particularly from elites who are likely to strongly resist the tax.

The empirical evidence in favour of centralised taxes is fairly weak. Francophone countries with relatively centralised systems vary in their effectiveness. For the most part they substantially underperform in relation to property taxation

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despite the supposed advantages listed above, as does Liberia, the most centralised anglophone country. Meanwhile, recent decisions to centralise collection elsewhere have had mixed results. An experiment with centralising collection in Tanzania from 2008-2014 was far from a clear success, and illustrates some of the complexities at play. Although local authorities in Dar es Salaam were performing very poorly in relation to property taxation prior to 2008, there was only a minor improvement in the first year after the central tax agency took control; after this, tax collection flatlined for several years. This only changed significantly in 2012/13, when there was a marked increase in property tax collection. However, tax collection was returned to the local level in 2014 after sustained lobbying from local authorities, precipitating an even more significant increase.

This brief account illustrates that improvements in tax collection in recent years cannot be attributed directly to either central or local control. Instead, it was general improvements in property tax administration that seem to have made the difference, such as the introduction of cashless collection and the updating of property registers.[2]

[2] Prichard, W. and Fish, P. (2017) *Strengthening IT Systems for Property Tax Reform*, ICTD Summary Brief 11, Brighton: IDS.

The centralisation in 2008 played a role in helping to develop more sophisticated cashless systems for payment. However, any gains from this were undermined by poor working relations between central and local authorities after the central agency took over, and the lack of strong incentives for the centre to collect the tax. This is why the re-decentralisation led to even better results: the cashless system instituted by the centre remained in place, but the incentives for collection were realigned, putting the authorities who stood to benefit from the tax back in charge of collecting it.

Moving the responsibility for collecting property taxes further up the government hierarchy has yielded more impressive gains in some countries. Nigeria provides a significant example, though an unusual one given that it has a federal system – which in Africa is relatively rare. Lagos State has led the way in centralising most aspects of property taxation at the level of the State since the late 2000s, consolidating several property-related taxes (some of which were previously collected and administered more locally) with relative success. However, centralisation within a federal state is not the same as centralisation at the national level. Indeed, this success depended on the desire of the Lagos State authorities to assert their independence from the federal government by raising more revenue of their own.

In the 2010s, other countries – including Rwanda from 2014 and Tanzania again from 2016 – have recentralised elements of property taxation, though it is still too early to judge the results. The risks of centralisation, which are implicit in the points made above in the case for decentralisation, bear repeating. Even if more sophisticated technically, the previous Tanzanian experience and early outcomes in Rwanda demonstrate that the question of whether central authorities will pursue the collection of property tax rigorously is a very real one. Central agencies may also lack the local knowledge needed to map new property developments accurately. Moreover, if local authorities do not feel that they have been adequately consulted, the ensuing mistrust and lack of cooperation can undermine any other gains made through centralisation.

> “In reality, many systems have elements of both central and local control. The appropriate combination depends on political systems, governance structures and historical legacies.”

Aligning function with scale: registration, valuation, collection and administration

Overall there is a distinct lack of evidence about which approach is likely to yield the best results. This is partly because the question of whether to tax property centrally or locally is an oversimplification – it conceals the complexities of property taxation as a multifaceted process, the experience of which is highly context-specific. In reality, many systems have elements of both central and local control. The appropriate combination depends on political systems, governance structures and historical legacies.

The following aspects of the tax need to be considered in terms of whether they are more appropriately sited at the local or central level in a given context:

- *Property tax policy:* the setting of tax rates (the proportion of property value to be paid in tax), as well as the tax base (what kinds of property are taxable) and method of valuation, are central aspects of the property tax system. In some cases, such as post-colonial Kenya, the centre retains control over these decisions even if collection and administration are decentralised, raising questions about the depth of local fiscal autonomy.
- *Property registration for tax purposes:* in theory, local authorities may be better placed to spot new properties and ensure that they are registered for taxation, and to maintain these registers. However, national governments often maintain legal property cadastres, which are used primarily for facilitating and regulating property markets, rather than for tax purposes. How exactly these legal cadastres are linked to the registration of property for tax purposes, and the role of local relative to central government in linking these systems, is crucial for effective valuation and collection.
- *Property valuation:* even where property databases are held locally, it does not necessarily follow that valuation is best done locally.[3] Where there is national capacity for approaches such as computer-assisted mass evaluation, but limited capacity to roll this out through local authorities, it may make sense for valuation to be centrally supervised. However, in many African countries there is a severe deficit of both property valuers and valuation technologies. This leads to a dependence on basic area-based rates and self-assessment, which may be better overseen locally.
- *Tax collection and enforcement:* in some countries the tax is collected by central authorities, but this is merely a service performed on behalf of local authorities who still administer the tax. The argument for this usually rests on the greater technical capacity and political weight of central agencies when it comes to enforcing payment. However, as noted above, the motivation for national agencies to collect the tax thoroughly may be low, since they do not gain directly from the taxes. The question of how the central authorities will be paid for their services, and how this affects the net tax earnings of local authorities, is also important.
- *Tax administration and budgeting:* the overall administration of property taxes, in terms of accounting and budgeting, is something that local authorities are usually keen to retain at the local level. Yet central authorities often have greater skills and more advanced IT systems,[4] and where local capacity is low there can be substantial problems in transparency and effective record-keeping. However, the greater the role that central authorities play in administering local budgets, the more of the share of local revenue they might be expected to keep.

Some of these responsibilities rest at central level and others at the local level in many countries. The nature of this arrangement often depends on historical legacies as well as other contextual issues.

[3] Zebong, N., Fish, P. and Prichard, W. (2017) *Valuation for Property Tax Purposes*, ICTD Summary Brief 10, Brighton: IDS.

[4] Prichard, W. and Fish, P. *Strengthening IT Systems for Property Tax Reform*, ICTD Summary Brief 11, Brighton: IDS.

Central-local relations and the role of intergovernmental transfers

These complexities highlight the fact that success is less about how centralised or localised the tax is per se, and more about the specific nature of central-local relations in a given context, and how conducive these are to effective partnership. Central-local relations in democratic countries depend on whether the same political party is in power locally as nationally, and how this affects inter-governmental cooperation. Yet there are other reasons for strained relations between central and local government, which may relate to conflicts over spending priorities or disputes over the appropriate level of intergovernmental transfers.

While there is not space to discuss these in detail here, the formula for transfers of revenue from central to local government can have an important effect on how well property taxation functions. All but the largest municipalities in most African countries depend on transfers. A very heavy reliance on transfers can create a disincentive to raise property taxes significantly – these taxes are unpopular and may ultimately lead to transfers being reduced. There are therefore good reasons to try and link the amount a local authority receives in transfers to the potential property tax yield in the area, in order to incentivise local authorities to maximise collection. Producing a workable formula for this can be difficult in practice, however.

The relationship between transfers and the effectiveness of property taxation can also unfold in more informal ways. Central government agencies may even withhold transfers in situations where they do not have an interest in cooperating with local authorities for political reasons. If property tax collection rests with local

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authorities, this withholding of central funds can breed a strong determination to collect taxes effectively, which sometimes yields results. However this is far from guaranteed, especially since property taxes are generally unpopular. In many contexts when local authorities are starved of central funds, a more likely outcome is that they seek to gain political capital by blaming central government for lack of revenue, as happened in Kampala during the 2000s.

In analysing whether central-local relations are conducive to effective property taxation in a given context, it is important to distinguish between central control itself and recentralisation. The latter involves a situation where taxes had previously been decentralised, with significant capacities and commitment to the tax developed at the local level, before some aspects of taxation were claimed back by central government. Policy shifts in Rwanda and Tanzania have been controversial and problematic in large part due to the ill will they have generated between local and central authorities, with the former perceiving that something has been taken away from them. This can result in a lack of cooperation on the part of local authorities, further worsening relations with the centre and inhibiting effective taxation. In Tanzania from 2008-14, for example, it was not so

much the fact of central control as the process of rapid recentralisation and the lack of cooperation it generated that accounted for the poor outcomes.

Conclusions and ways forward

The complex mix of the capacities and incentives needed for effective property taxation illustrates how sensitive it is to context, and the degree to which one-size-fits-all policies are ill-advised. In general, experience would seem to indicate that while *technically* central governments may be better placed to manage aspects of the tax such as collection and administration, centralised taxation is significantly more problematic in terms of the alignment of incentives with performance. This includes both the incentive to collect the tax, and the incentive to be responsive and accountable about how the taxes are spent.

Local governments, by contrast, can be highly politically incentivised to collect the tax in order to assert their autonomy and improve local services. However, if the centre provides little moral and logistical support for their efforts, a contrasting political incentive can come to predominate, with local authorities letting many taxpayers off the hook in order to maintain popular goodwill. The crucial factor determining whether local authorities pursue property taxation effectively is whether they manage to create a convincing discourse around it being a good and fair tax that brings tangible benefits to citizens.

In thinking about which specific roles central and local governments are best placed to play in a given context, policymakers may wish to consider the following issues:

- What is the history of property-related tax collection in the country in terms of central-local government roles and relations? What are the main obstacles and bottlenecks to more effective property tax collection? Are there good reasons to believe that in this context a shift in central-local relations (rather than consolidating roles at existing levels of government) will address these problems?
- If a shift is needed, which specific aspects of property taxation should be relocated, and how can this be done in the least disruptive manner? How would a shift in aspects such as registering properties or collecting taxes be constrained by political economy considerations in the municipality in question?
- How far down the road to fiscal decentralisation has the country already travelled? If local authorities have developed systems for collecting and administering the tax, which are improving (even if slowly) and helping to build local accountability, the effects of centralisation on local morale and commitment may outweigh perceived efficiency gains.
- Which services can be clearly linked to the tax, and who is providing these? If the provision of services that can be linked to property values has been substantially decentralised, then it makes sense for property taxes to be at least partially administered at the level of government closest to that provision.
- Which level of government is responsible for surveying land and registering land titles? How can legal cadastres for this be developed in a mutually supportive way to the development of fiscal cadastres, and what are the implications of this for which level of government should oversee the latter?
- Which system of central-local government transfers is in place, and how does it affect incentives for property taxation?

Further reading

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Credits

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