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THE PROPRIETY OF PROPERTY RATES TAX IN KAMPALA CAPITAL CITY AUTHORITY

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ABSTRACT

Property rates tax can be defined as a tax on properties such as private houses, commercial houses, factories and banks paid to local governments based on their rental value. The base for the property rates tax is "real property" defined as land and improvements or attachments to the land. A number of considerations need to be taken into account in designing or scrutinising a tax proposal. Economists have categorised concepts that can be used in evaluation of a tax system in different ways. However, most of the criteria used in evaluating a tax system are founded on the traditional Adam Smiths' four canons of taxation - equity, that is fairness with respect to the tax contributions of different individuals; certainty, that is a lack of arbitrariness or uncertainty about tax liabilities; convenience, that is with respect to the timing and manner of payment; and efficiency, that is a small cost of collection as a proportion of revenue raised, and the avoidance of distortionary effects on the behaviour of taxpayers (the principle of neutrality). These canons provide a framework within which various tax system proposals may be considered and can also be used to set a basis for assessment of the propriety of property rates tax. Admittedly, it is hard to design a tax system that incorporates all these principles, but there should always be endeavours to ensure that the majority are met. The purpose of this article is to analyse how property rates tax, theoretically and practically (in Kampala Capital City Authority in Uganda) meets these principles. However, not all the canons of taxation are reviewed. The discussion concentrates on those which are considered more critical in the property rates tax system.

INTRODUCATION

Property rates tax can be defined as a tax on properties (private houses, commercial houses, factories, banks) paid to local governments based on their rental value. **(Murangira, 2014).** The base for the property tax is "real property" defined as land and improvements or attachments to the land (**Rutherford and Bone, 2003**). A number of considerations need to be taken into account in designing or scrutinising a tax proposal. Economists have categorised concepts that can be used in evaluation of a tax system in different ways. However, most of the criteria used in evaluating a tax system are founded on the traditional Adam Smiths' four canons of taxation (**Smith, 1776**) - equity, that is fairness with respect to the tax contributions of different individuals; certainty, that is a lack of arbitrariness or uncertainty about tax liabilities; convenience, that is with respect to the timing and manner of payment; and efficiency, that is a small cost of collection as a proportion of revenue raised, and the avoidance of distortionary effects on the behaviour of rate payers (the principle of neutrality). These canons provide a framework within which various tax system proposals may be considered and can also be used to set a basis for assessment of the propriety of property rates tax. Admittedly, it is hard to design a tax system that incorporates all these principles, but there should always be endeavours to ensure that the majority are met. The purpose of this article is to analyse how property rates tax, theoretically and practically as applied in Kampala Capital City Authority (KCCA), meets these principles. The article focuses on KCCA established under the Kampala Capital City Authority Act, No. 1 of 2011. The choice of KCCA as a case study was motivated by several reasons. First, Kampala is the heart of Uganda's business centre making it assume strategic significance in the national economy and subsequently commanding high influence on the possible effectiveness of policy measures. Second, its unique features and complexity such as property development patterns offer opportunities for learning important lessons that could be

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applicable elsewhere in Uganda such that whatever happens in the KCCA can be rolled out to other local governments in Uganda. Third, the property rates tax system is well developed in KCCA than in any other local government in Uganda. Fourth, the area under study was within reach of the author and it was easy for the writer to get information readily available for this article. There are ten principles of taxation. These are: Equity and fairness, certainty, convenience of payment, economy in collection, simplicity, neutrality, economic growth and efficiency, transparency and visibility (legitimacy), minimum tax gap and appropriate government revenues (**Nellen (2006)**. However, not all the canons of taxation are reviewed. The discussion concentrates on those which are considered more critical in the property rates tax system.

The Principle of Equity or Fairness

From the above background, there is need on the part of the author to discuss in detail the applicability of the principle of equity or fairness to property rates tax system in KCCA. The tax system should be fair in its treatment of different individuals. The fairness of a tax system is in many cases seen as a simple phenomenon that can be achieved by a tax structure that differentiates tax burden according to chosen criteria in an economy (**Kayuza, 2006)**. There can be varying perceptions about what constitutes a fair tax system. However, the common approach used by economists is to describe fairness of a tax system in terms of horizontal equity and vertical equity (*Ibid*). Horizontal equity means that like rate payers are taxed alike (**DeBoer, 1997)**. Achieving horizontal equity involves a complicated question of defining the meaning of two individuals being identical in all relevant aspects and what equal treatment means. It may be very difficult to identify two individuals identical in all respects so as to achieve horizontal equity. Income is one aspect that provides a tax base operating on the presumption that individuals earning the same income pay the same tax. But if one examines the tax burden of two individuals considered as treated equally, one may find that the tax burden is not the same. For instance where two people earn the same amount but they share different burdens say from relatives, charging the same amount of tax may not produce fair results. In these circumstances, the principle of horizontal equity becomes too difficult to apply practically (**Kayuza, 2006**) in KCCA.

Vertical equity means that rate payers in different circumstances be taxed differently, in an appropriate way (**DeBoer, 1997**). This is a phenomenon of progressive taxation. Accordingly, individuals with a higher level of economic wellbeing should pay higher taxes than others should do. A problem that emerges from this proposition is determining who actually should pay tax at a higher rate and how much more should the rich pay than others. The widely used yardstick for determining who should pay at the higher rate is the level of income of each rate payer (**Kayuza, 2006**). The level of income-yardstick requires that higher income an individual earns is translated as a greater ability to pay and therefore justifying higher taxes. The secondary question that arises is how much more should those individuals with higher incomes pay. A widely accepted view is for the rich to pay a higher fraction of their incomes in taxes, leading to a progressive tax system (*Ibid*). Theoretically, the author feels that property rates tax system can be said to be fair in KCCA in two respects. First, it is those with properties to rent out that are liable to pay rates and owner-occupied properties are exempt **(Section 3 of the Local Governments (Rating) Act No. 8 of 2005**). This implies that as the incomes of the persons increase, thus acquiring more properties, the higher the rates they will be liable to pay and the lower the person's income, the lower or even no rates are payable owing to the fact that they have no property. Likewise, the higher the rental value of the property (implying high rental incomes for the rate payers), the higher the rates they pay, and vice versa. To this end, the property rates tax system meets the vertical equity principal. This position may, of course, not always be accurate depending on the nature of expenditure of individuals. A different conclusion may be made where for instance a person, although earning less considers investing in real estate so important than saving the money and keeping it in the bank; while the other is earning so much but invests less in real estate. Although both earn different income, the former may pay higher rates than the latter notwithstanding that his total income is less.

Nevertheless, since we consider income in terms of income from the property, it is strongly argued that a property rates tax system still meets this principle. The former although earns less from other sources, he earns more from property and should pay more tax than the latter, who earns more from other sources but very less from real property. Second, property rates tax meets the horizontal equity principle since it is levied basing on the rental value of the property and therefore, where two people own different properties with the same rental value, they are liable to the same amount **(Section 11 of the Local Governments (Rating) Act No. 8 of 2005**). This proposition presupposes that the valuation of the rental value is accurate, otherwise, an inaccurate valuation will assess the two persons the same amount of tax but in fact one realizes less than estimated. This will affect the ability of property rates tax to meet this principle.

In practice, this principle can be achieved where all taxable properties are valued regularly **(Section 24 of the Local Governments (Rating) Act No. 8 of 2005)**. The valuation must be fairly accurate to ensure that properties of similar values would be subject to similar tax liability and properties of different values would bear varying tax burden. The property rates tax system in KCCA has substantially failed to meet horizontal and vertical equity in practice. This is because there are a number of properties that are not valued and, therefore, the owners do not pay property rates tax, despite earning substantial income from such properties and in some cases more than those which are valued. The other facet where property rates tax system fails to meet the equity canon of taxation in practice is in respect of owner-occupied properties. Owners of such properties are well to do persons who are very able to pay property rates but they are exempted. It was noted from the respondents that a number of persons in owner-occupied properties are paid rental allowances and could be able to pay the rates for the houses they occupy.

Neutrality Principle

This article explores how the neutrality principle is applicable in property rates tax system in KCCA. The author feels that for a tax system to be fair, such tax has to be neutral as far as rate payers are concerned. Neutrality requires that the tax system itself should influence as little as possible the way in which economic activities are carried out (**Bakibinga, 2003**). This means that investment, business and economic choices should be made without regard to the tax consequences of the choices (**Norton, 2000**). A tax system should not deter extra work being undertaken on the grounds that high taxes would be paid on the additional wages than on the slice income immediately below them (**Bakibinga, 2003**). A tax system is thus regarded as neutral if it causes little or no interference in the functioning of an economy. A tax, when imposed on a particular product, should not force consumers to switch from the consumption of that particular product to another product that attracts lesser tax. Property rates tax is imposed on real properties as defined by section 2 of the Local Governments (Rating) Act No. 8 of 2005. These being fixed assets makes it hard for the rate payers to change their investment choices because high taxes are payable. For example, in Uganda, it cannot be imagined that a property owner can opt to sell his property solely because the rates are too high and establish another business in the alternative. If any effect is felt, it only discourages other persons willing to establish such properties from doing so. Moreover, the rates usually charged are not high to invite such a behavior. Along this line of argument, it is submitted that property rates tax in Uganda to a grater extent meets this canon.

Legitimacy

One of the reasons for the government imposing a tax on individuals is generating revenue that supports its functions. Supply of public goods is among the most important functions for which individuals must be made to contribute through paying taxes. Among the public goods there are those whose benefits can be directly observed by the individual rate payers such as construction of civil works, national health programmes, parks and so on. But in some cases of public goods like defence, the benefits may not be direct for the tax paying citizens to appreciate. This proposition is discussed in the paragraphs that follow. The principle of legitimacy requires that while individuals have the obligation to pay taxes to the government, they similarly have entitlement to being informed about their tax burden and other relevant aspects related to the taxes they pay. In view of this, it is important that a taxing authority operates in a transparent manner in that it is clear who is benefiting and who is paying (**Stiglitz, 2000**). It would obviously be ideal for a tax system if the rate payers were made to see the relationship between their contributions to the support of public goods and the supply of the same (**Walker, 1970**).

The author feels that if people are informed about the paying of taxes and what these taxes can do for them, they are likely to cooperate more and the taxing authority is likely to be accountable as their actions will be observable by the informed rate payers. Under this principle therefore, it is important that the amount and quality of the supply of public goods is considered as an aspect that justifies the imposition of taxes to the citizens for a more efficient tax system. If a tax system is not seen as legitimate, then this can lead to direct economic costs, for example higher administrative costs in enforcing compliance owing to a substantial number of rate payers evading the otherwise unproductive tax system. Unless KCCA acts to the contrary, property rates tax fully satisfies this principle. Revenue collected as property rates tax is normally used to provide services to the people within its jurisdiction. Section 37 (2) of the Local Government (Rating) Act of Uganda provides that the revenue collected from rates must be used in the provision of services such as street lighting, garbage collection and road construction and maintenance. These are services that are visible to every rate payer. In practice, the property rates tax system in KCCA has failed to pass this test. The non-payment of property rates tax in Kampala is largely attributable to failure by KCCA to provide services. The rate payers, therefore, see no reason why they should pay for services which they do not receive. Rate payers find it quite in order for them not to pay the taxes since little or nothing was given in return. Secondly, whereas KCCA regularly publishes a report on the amounts collected from property rates, it rarely informs the rate payers what services the rates have been used for. This is worsened by the fact that there is no separate property rates account as required by law and the money is mixed up with other revenues and, at times, is used to pay salaries and claims for the KCCA officials. In these circumstances, the rate paying public cannot trace the direct benefits from the property rates tax system and it is, therefore, seen as illegitimate. This has far reaching implications, especially in the collection and enforcement process.

Certainty

The tax which every individual is bound to pay, ought to be certain and not arbitrary (Smith, 1776). This means that the following features must be clear and plain to the rate payer and any other person particularly the collector (**Bakibinga, 2003**). First, the time of payment, that is, whether the tax is payable yearly, monthly or quarter yearly and if possible the deadline of payment of such a tax. Both the rate payer and collector should be certain of the time when each tax is due (*Ibid*). Second, both the rate payer and collector should know the manner of payment, that is, whether it shall be by receiving cash or by cheque or some other form of credit whether individually by each rate payer deducted by his employer or, whether it must be paid in installment or lump sum or whether the rate payer can pay for the whole year instead of every month, and also the currency in which the payment must be effected (*Ibid*). Third, both the rate payer and collector should be aware of the amount to be paid, that is, how much a rate payer is expected at every moment to pay (*Ibid*).

The rationale for the requirement of certainty is to protect both the rate payer and government interests against the tax collector (*Ibid*). Thus certainty of a tax prevents aggravation of the tax upon any rate payer or extortion by the threat of aggravation, by the tax collector (*Ibid*). Where a tax system or taxation is uncertain, it encourages the insolence and favors the corrupt. Theoretically, property rates tax system in KCCA to a greater extent can be said to meet this canon. The Local Government (Rating) Act of Uganda comprehensively stipulates how the tax payable is to be assessed, how it should be paid, when it should be paid and where the rate payer should pay the tax. The credit awarded to property rates tax system on this canon presupposes functioning systems in assessment and payment procedures. Thus, where there are few valuers in a given area, the valuation process may be too slow and the rate payer will not know how much he/she is supposed to pay within the convenient time. Likewise, where payment for rates is to be made in the bank, property rates tax system may fail to meet this canon where there are long lines such that the rate payer has to come extremely very early in order to effect payment. In KCCA, the amounts payable are always known to the rate papers and the bank slips attached to the demand notices normally specify the bank and the branch where payments are to be made from. This notwithstanding, there is very limited awareness among the public about the method of assessing property rates tax. Many rate payers think that the rateable value of the property is the rate payable and they object on the basis that the assessment is very high. The formula for computing the rate payable is also fairly complicated for a common man to understand. Many rate payers also confuse property rates tax, rental income tax and ground rent, which they look at as double taxation. Rental income tax is a tax levied under section 5 of the Income Tax Act Cap 340, laws of Uganda on rental income from a rented property. On the other hand, ground rent is paid by a lessee of land to the authority that owns the land. In light of these, it can be said that the property rates tax system in KCCA is uncertain for many rate payers.

Administrative Simplicity

A tax system must be simple for the rate payers to understand it. Likewise, it is important that the administrative and compliance costs are kept as low as possible. Administrative costs constitute costs involved in running a tax system. These include costs of determining tax liability, as well as costs for auditing and enforcement functions. Conversely compliance costs are indirect costs borne by the rate payer. The costs of complying with the tax requirements can be in form of time spent on completing tax forms, costs of record keeping plus payment to accountants and lawyers for tax guidance. Administrative and compliance costs tend to be higher with a complex tax system. Under a complex tax system more resources are required for administering special provisions, differential tax rates and deterrent instruments. Similarly, the rate payer would spend more on understanding the tax structure and subsequently on attempts at tax avoidance and evasion. The complexity of the tax system increases the costs to both the tax authority and the rate payer (**James and Nobes, 2000**). For instance the costs borne by the rate payer in attempts to avoid and evade tax create corresponding administrative cost to the taxing authority in trying to hinder the process.

Given the increased administrative and compliance costs resulting from a complex tax system, it is vital that a simple tax system is in place so as to minimise the tax administration costs. High administration costs make it uneconomical to collect taxes. According to Adam Smith, (**1776**) a tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury if the levying of the tax may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax; and the forfeitures and other penalties which the unfortunate individuals incur, who attempt unsuccessfully to evade the tax, may frequently ruin them, thereby ending the benefit which the community might have received from the employment of their capital. Theoretically, property rates tax system to a greater extent meets this canon. First, it is fairly simple to understand and not complex to the rate payers. Assessments are made by the valuers and the amounts payable disclosed to the rate payers. What is required of a rate payer is simply to go to the local authority's office and pay the assessed tax. Second, the system accepts offsetting the rates due against the development works done by the rate payer (section 27 (3) of the Local Government (Rating) Act No. 8 of 2005). This reduces the costs on the side of the local authority in administration of the finances and the development works. Third, since property rates tax is imposed on real property, evasion is limited as it is impossible to shift the property to another place. Moreover, where the property owner fails to pay, the taxing local authority can recover the rates due from the tenants, without necessarily incurring the expenses of looking for the property owner (section 31 (1) of the Local Government (Rating) Act No. 8 of 2005). However, in practice, a small percentage of the potential property tax revenue is collected with minimum attempts to enforce compliance. Furthermore, the administrative costs are very high having regard to the paid KCCA surveyors in addition to the private firms contracted to conduct valuation and collection of rates. In light of these, property rates tax system in KCCA can be said to be inefficient.

Convenience to the Rate Payers

The tax should be paid at such times that are convenient to the rate payer (**Bakibinga, 2003**). The Government should ensure that the tax payer at a given time is in position to pay the assessed tax. Consequently; every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the tax payer to pay it. For instance, tax on income earned in employment is usually deducted at source as the employee is being paid (*Ibid*). It should be stressed that if the time or manner of payments is not convenient for the tax payer, it is the government that loses or suffers the consequences in tracing the rate payers to pay taxes. For property rates to be convenient, they should be payable at the same time when rents are paid. The system of payment of two installments for property rates appears to be convenient to the rate payers because they are able to pay in any period of the year. Property rates tax system can also be convenient where the rates are payable from the bank thereby saving the rate payers from the burden of lining up at the local government office to make payments. In KCCA, the inconvenience in the property rates tax system is seen in the payment system that requires all the rates, however small, to be paid at the bank. In certain Divisions of KCCA, the banks are located far away from the rate payers. A lot of time is wasted while the rate payers travel to the banks to pay the rates. Most times the rate payers spend a lot of time in long lines in banks before they could eventually do the banking.

Conclusion

Property rates tax system in KCCA satisfies a number of canons of a good tax system in theory. However, the practice in KCCA shows that the system misses most of these principles. Key reasons for this trend include limited awareness among the rate payers and in some cases the taxing authorities and failure in service delivery that in turn attracts resistance from the rate payers in payment of the taxes and high administrative costs in an effort to enforce payment. These are key areas which KCCA must work on to ensure the efficient operation of the property rates tax system.

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