Reforming Property Taxation: The Case of Municipal Corporation of Greater Mumbai

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ABSTRACT

Municipal governments are required to provide various civic infrastructure services to the citizens and they levy different types of taxes and user charges/fees for raising revenue in order to meet the costs of providing such civic services. Property tax is considered as the backbone to the own source revenue of municipal governments in India. However, several Indian cities have not been able to tap the full potential of it for several reasons. One of the important issues affecting property tax revenue is that their taxation systems are designed on the basis of - Annual Rateable Value (ARV) of properties. Mumbai is the first Indian city to move away from ARV system towards adopting Capital Value (CV) based taxation of properties as a step forward. It also adopted a more rational Unit Area Method (UAM) for calculating property tax. The reforms led to gains in property tax revenue for the Municipal Corporation of Greater Mumbai (MCGM). This case describes the salient features of this property tax reform undertaken by the MCGM, which can be replicated by other Indian cities.

Keywords: *Property tax, ARV system, Capital Value, UAM and MCGM*

INTRODUCTION

Municipal or urban local governments are constitutionally obligated to provide various civic infrastructure services to the citizens in cities in India. In a scenario of rising population and increasing levels of urbanization, the burden of providing civic services is only rising in India (MGI 2010). The provision of these civic infrastructure services in cities requires a large amount of spending by the municipal governments, especially when we take into account of service backlogs

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(HPEC 2011). In order to meet the costs of providing these civic infrastructure services, the municipal bodies levy various taxes and user charges/fees that provide own source revenue. Although the municipal bodies do get grants-in-aid from the upper tiers of governments, they are primarily provided so as to fill the gap between own source revenue and expenditure obligations i.e., grants do not form an important parameter when it comes to planning, design and implementation of civic service delivery.

Property tax is an important source of tax revenue for the municipal governments that is their own source revenue and it is almost universal (Walters 2011). Property tax is considered as an appropriate tax because of the 'quid-pro-quo' principle i.e., the property owners are beneficiaries of the civic infrastructure services and will be willing to finance their provision by a local government institution (Oates 2005). It is also considered as appropriate for local governments because the properties are 'immobile' therefore cannot be exported/shifted to another location, which is unlike taxing the businesses which may quickly relocate to lower tax jurisdictions that results in tax export (Bahl and Linn 1992).

Taxing real property also leads to the formation of a 'lien' in the event of non-payment of tax by the property owner (Jacobus 2010). Property tax lien is a superior lien with the back-up of statutory powers with which the municipal government can attach the real property and take possession of it in the event of non-payment of tax, so as to recover the tax dues from its owner (ibid). In spite of such strong powers, the municipal governments in India have not been able to exploit the full potential of property tax revenue from their cities. There are several reasons for this given by the municipal finance experts (Mohanty 2016; Rao 2013):

- Property Tax base i.e., number of assessed properties on which property tax is levied, has been narrow in most Indian cities and it has not been growing over time, because municipal bodies in India are slow in identifying uncovered as well as new properties and assessing them regularly over time – particularly, in the peripheral areas.
- Revision of Property tax rate is also not taken up regularly by the municipal bodies in India, as it requires the vetting of the council of elected representatives of municipal body (which is difficult due to the political resistance) and also it requires taking the approval of the State government.

- Organisational inefficiencies of municipal governments with regard to the assessment of properties from time to time, calculating the tax, sending tax demand notices to owners, collecting tax at different outlets, resolving the issues of tax arrears, setting channels for grievances and dispute resolution, etc.

Nevertheless, improvingthe property tax revenue mobilisation by overcoming the above issues is a long way to go to achieve it i.e., it requires strong commitment of leadership and resources by the municipal government. It is here that the systemic improvements to taxation and innovations come into play, which emphasize on making the whole property taxation system to be made simple, transparent and accountableso that they become acceptable to the public and polity (Mohanty 2016). This requires the municipal governments moving away from current archaic property taxation systems and practices to adopting new systemsthat can improve revenue, as demonstrated by Hyderabad in the past (Mohanty 2003).

Indian cities have for long been following a system of property taxation based on the 'Annual Rateable Value (ARV)', which is based on the rental value of property and is known for it being atax-assessor driven, non-transparent and complex system to understand (Karnik 2005). Several tax payers moved to courts in the past seeking clarity on taxation and protection from the arbitrariness of municipal tax officers. Also, the underlying distortions in rental markets of cities (due to the operation of rent control acts in cities) have dented the potential revenue considerably (as rent controlled properties contribute little or no tax) (Gnaneshwar 2009, Rao 2013).

In this context, the Capital Value (CV) based system of property taxation is considered to be a more appropriate choice as it detaches the tax base from 'assessed rental value' property' of the ARV system and moves towards the 'guided capital value of property'based on the exchange value of property (Karnik 2005). It can then be combined with other improvements in property taxation, which will render it simple, predictable and transparent. The Unit Area Method (UAM) is considered to be the appropriate one in this regard, which can make the property taxation more rational, simple, transparent and easy to understand. Cities like Bangalore have moved towards such methods for assessing tax and saw improvements in the mobilization of property tax revenue (Ahluwalia 2011).

The Municipal Corporation of Greater Mumbai (MCGM), the municipal local government of Mumbai city, is the first municipal government in India to adopt the CV based property taxation system in India. It also adopted a UAM for the computation of tax which was simple, transparent and easy to understand, which gave rise to some significant improvements in property tax levy, collection and transparency. This paper is positioned in the above context as a useful one to elucidate the importance of property taxation reform so that it leads to aimproved property tax revenue that can be utilized by the municipal governments to provide better civic infrastructure services to the citizens.

Earlier System of Property Taxation

The MCGM is the urban local government concerned with the development of Mumbai city and also with the provision of all major civic infrastructure services to the citizens. The MCGM jurisdiction extends over an area of 432 sq km covering more than 12.45 million population contained within it (Census 2011). It provides a wide range of civic infrastructure services like water supply, sewerage, drainage, roads, street lights, solid waste management, parks and play grounds, education and healthcare services. Like any other urban local government, the MCGM also levies various taxes and charges/fees to recover the expenditure incurred on providing the civic services and also to meet the operation and maintenance costs of the civic infrastructure services. Property tax is an important means of realizing revenue, by levying a tax on the real properties within its jurisdiction.

For a long time, MCGM followed the property taxation based on the concept of levying tax on the (rental) income arising from the property, which is a legacy of the municipal finance system of the British rule in India. Municipal governments in Britain and several Commonwealth countries follow the principle of taxing the (rental) income accruing on tothe property, which they consider as legitimate taxation principle. This principle of property taxation has brought in the practice of 'Annual Rateable Value (ARV)' as the basis for property tax levy. The ARVof a property is assessed by the tax assessing officer of the municipal government, based on the survey of sample properties or records of rental transactions or registrations of rental agreements in the area in which the property is located.

The ARV based assessment of property value and the system of property taxation based on such assessed rental income from property have several practical constraints in the developed and developing country cities viz.,

- There are procedural issues associated with the assessment of ARV of a property. In some localities in the cities, renting of property may be absent or present for a small number of properties, making it difficult to assess the rental value of real properties in such localities.

- There could be a systematic under-assessment of property values due to a limited number of rented properties getting registered (which alone are considered by municipal tax assessor in the process of tax assessment) and even they may not genuinely reflect prevalent market rent; also,all rental agreements are not renewed at the expiry of term which leads to the absence of new/revised rental value of property.
- A large number of properties came under the ambit of the Bombay Rent Control Act, 1947, which imposed ceilings on annual rents leviable on properties and they were later frozen for several decades. This led to negligible rental income accruing to owners of such rented properties and therefore negligible tax revenue to the MCGM. It also led to practices like 'hidden rent' (a higher amount charged by owner than standard rent), which is not reflected in the tax assessment.
- The rental value assessment of properties and taxation based on it under the ARV system gave a lot of discretionary powers to the tax assessor in the municipal body and it was also subjected to disputes between property owners and municipal body, some of them went to the court that took a long time to dispense them. The municipal body lost tax revenue in the meantime until the dispute is settled.
- The ARV based taxation also resulted into the spatial inequity of civic services in Mumbai. The rent controlled properties in South Mumbai were contributing hardly any tax revenue but getting good quality of civic infrastructure services, whereas the new properties in North Mumbai outside rent control act were contributing the most to the tax revenue but were not getting good quality civic infrastructure services.
- All the above shortcomings of the ARV system of property taxation have led to severe revenue shortage to the MCGM. Also, the property tax revenue had become stagnant in the MCGM for several years due to artificial low rents prevalent in rental property markets and non-revision of property tax rates for a long time. It paved the way for reforms in property taxation in Mumbai.

Property Taxation Reform in Mumbai

Some of the shortcomings of the ARV system were identified by a few European countries in the early to mid 1980s and they began to find alternates. One such alternate system of property taxation that has been accepted in some of these countries is the property taxation based on the 'Capital Value (CV)' of property. The CV based property taxation dwells on the transaction (purchase/sale) value of properties, which are mostly registered for securitising the transaction as required under the Transfer of Property Act. Therefore, it reflects 'market value' commanded by property when compared to 'imputed value' of it under ARV system. However, tax rate structure of CV based taxation system is different from that of ARV system. Therefore, it has to be devised based on the survey of properties while also subjecting to the principles of equity, effectiveness, acceptability and fairness.

The Unit Area Method (UAM) of computation of property tax was first done by the Patna Municipal Corporation, which was rather simple, transparent and easy to understand (Gnaseshwar 2009); the courts have also upheld such system. The UAM makes the entire tax assessment rather objective and the calculation of tax can even be done by the citizen to check if the tax assessor is levying the right tax amount or not. The UAM is based on the categories of the properties on the major parameters that determine its value, viz.,

- Location of property;
- Use of property;
- Construction type of property;
- Age of Property; and
- Amenities of property.

Property Tax Assessment Methodology

In the new approach to property taxation based on the CV adopted by the MCGM, it was proposed to adopt a simpler method for computation of property tax based on the following parameters of property value as featured in UAM assessment:

- Market Value of Property
- Area of the Property unit
- Construction Category
- User Category

- Age Category
- Floor rise Category
- Tax rate

(i) *Computation of (Guided) Market Value*

The parameter 'Market Value of Property' is actually 'Guided Market Value of Property' drawn from the *Ready Reckoner Guide* published by the MCGM, which gives both capital as well as rental values of properties in different localities in Mumbai as guiding figures for computations related to registration, stamp duty and taxation purposes. The *Ready Reckoner Guide* is prepared by the Valuation Department of the MCGM based on the survey of a sample of real properties in a locality, which is carried out in all major localities in Mumbai. It is published by the MCGM and available in the public domain.

(ii) *Area of the Property Unit*

The parameter 'Area of the Property Unit' refers to the built space of the property unit. It therefore, refers to the habitable area occupied by the property unit i.e., carpet area, and does not include the common area/ built space for uses like staircases, lobby and common facilities/amenities.

(iii) *Weightage Sets for Other Categories*

For the remaining parameters, the MCGM has devised a weightage system, which assigns different weights to different categories. Each of them is based on the influence that they will have on the property value. The various categories and their weightage sets for each parameter are given through Table 1 to 4. The weightage set, however, is valid for properties/ houses developed and not for undeveloped/ vacant land.

TABLE 1: CONSTRUCTION CATEGORIES AND WEIGHTAGE SET OF PROPERTIES

Construction Category	*Construction Type*	*Weightage*
C1	*Pucca* Building	0.7
C2	*Kachha*/Semi-Permanent Structure	0.5
C3	*Chawls*	0.5
C4	RCC Structure	1.0
C5	(RCC Structure (Luxurious	1.25
C6	Bungalows	1.25

Source: MCGM (2013)

TABLE 2: USER CATEGORIES AND WEIGHTAGE SET OF PROPERTIES

User Category (UC)	*User Type*	*Weightage*
U1	Residential	1.0
U2	(Commercial (Shops & Offices	1.25
U3	Industry/Factory	1.25
U4	Malls and multiplexes	1.25
U5	Hospitals	1.0
U6	(Hotels (below 5 star	1.0
U7	Hotels 5 Star	1.25
U8	Educational institution	0.7

Source: MCGM (2013)

TABLE 3:AGE CATEGORIES AND WEIGHTAGE SET

Age Category (AC)	*Year of Construction*	*Weightage*
A1	Pre 1940	0.5
A2	1941-1960	0.7
A3	1961-1970	0.8
A4	1971-1985	0.9
A5	Post 1985	1.0

Source: MCGM (2013)

TABLE 4: FLOOR CATEGORIES AND WEIGHTAGE SET

Floor Category (AC)	*Floor Level of Property*	*Weightage*
F1	Ground Floor to 4th Floor	1.0
F2	5th to 10th Floor	1.05
F3	11th to 25th Floor	1.1
F4	21st to 30th Floor	1.15
F5	31st to 50th Floor	1.2
F6	51st to 75th Floor	1.25
F7	76th to 100th Floor	1.3
F8	Above 100th Floor	1.35

Source: MCGM (2013)

(iv) *Tax rates of Properties*

Tax rates for the properties are also devised for various user categories by the MCGM. Property tax levied by the MCGM is a composite tax which consists of – general tax, fire tax, street tax, education cess, water tax, water benefit tax, sewerage tax, sewerage benefit tax, tree cess, State education cess and employment guarantee cess. The tax rates applicable to different users are shown in Table 5.

TABLE 5: TAX RATES AND USER CATEGORIES

User Category (UC)	*Description*	*Tax rate (%)*
U1	Residential Buildings	0.7887
U2	Open Land (Residential), Industrial Buildings, (Other Non-Residential Buildings (listed	1.407
U3	Developed Land, Open Land (Non-Residential), Non-Residential Buildings	1.759
U4	Commercial Properties	2.815
U5	Commercial Institutional Buildings	5.628

Source: MCGM (2013)

Computation of Property Tax

Based on the property unit falling in the various categories and other observations with regard to guided market value of property, the property tax can be computed using the following formula:

$$PT = r*MV*Area*CC*UC*AC*FC$$

Where:

- PT is Property Tax (in Rs)
- r is tax rate (%)
- MV is guided market value (Capital Value in Rs)
- Area is carpet area (sq ft)
- CC is Construction Category Weightage
- UC is User Category Weightage
- AC is Age Category Weightage
- FC is Floor Category Weightage (applicable to multi-storeyed RCC buildings)

Box 1 shows the examples of computation of property tax for hypothetical residential and commercial properties (for which the relevant data exists) in the jurisdiction of the MCGM.

Impact of Reforms on Property Tax Revenue

Property tax reforms in Mumbai were by all means not a simple exercise. The design of CV based taxation took a long time after performing a detailed analysis of how the new method of taxation would have an impact on the tax of individual properties. Certain safeguards were placed so that it would not result in disproportionate burden on tax payers, especially those of poor and low income groups. Public

Box 1: Examples of Property Tax Calculation

Residential Property

- Consider a residential property of RCC built after 1985 located on 16th floor with built-up area of 88 sq m whose market value is Rs 25480 per sq m
- Property tax = (0.7887/100)* 25480*88*1.0*1.0*1.0*1.1
  = 19,453

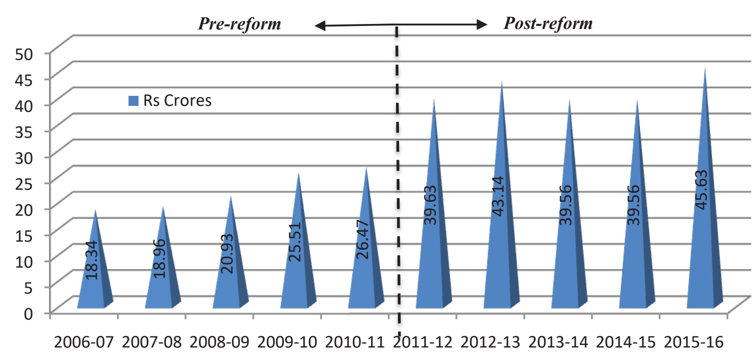
Commercial Property

- Consider an office property of RCC built after 1985 located on 21st floor with built-up area of 58 sq m whose market value is Rs 29480 per sq m
- Property tax = (2.815/100)*29480*58*1.0*1.25*1.0*1.15
  = 69,190

Source: Based on the MCGM Property Tax Manual

feedback was taken to understand their concerns and to address them in the adoption stage. The new method was also given wider coverage by bringing in media and civil society groups to take it to the citizens. The MCGM began adoption of new system partially by 2009-11 and completed it by 2011-12. The adoption of this new property taxation system based on the CV and UAM computation led to significant tax revenue improvements in the MCGM, as evident from Fig. 1.

Fig. 1: Trend of Property Tax Revenue of the MCGM



Source: Awasthi and Nagarajan (2020)

CONCLUSION AND DISCUSSION

Property tax is an important statutory tax and only lien with statutory powers to attach property. Yet, most of the Indian cities do not perform well on property tax revenue mobilization. The ARV basis of taxation is considered to be one of the reasons for the under-performance on revenue mobilisation. Mumbai is the first Indian city to reform property taxation by adopting 'Capital Value' based system of property tax. It successfully implemented the property tax reform, got the results of revenue improvement due to the simplicity associated with the computation of property tax and easier understanding of the capital value of property by citizens. Given the success of this taxation reform other Indian cities can also move towards its successful adoption.

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