

# REFORMING OF PROPERTY TAX SYSTEM IN KARNATAKA

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## ABSTRACT

*Property taxation is universal; it is hard to find a country which does not levy a tax on its landed property. The best tax policy in the world is worth little if it cannot be implemented effectively. The level of tax yield of property has been below the expected tax yield due to assessment issue. The function of valuation is to ensure fair assessment of property owners. This paper examines the taxonomy of property tax with a view to understanding its composition and review the impact of valuation accuracy on property tax from existing literature. The study reveals the impact of valuation on property tax, indicating the effects of valuation accuracy on the amount of tax payable or receivable as the case may be. Valuation impact can be viewed as being accurate or inaccurate. When it is accurate the cost is low for the tax administration, low rate of avoidance and evasion, and provision and maintenance of municipal services, but the reverse is the case when it is inaccurate. The study recommends that tax authorities should engage qualified professionals in the assessment of property tax and that regulatory bodies should organize periodic training for their members.*

**Key words:** Equity, property tax, tax yield, valuation accuracy and inaccuracy

## INTRODUCTION

Property tax is the most important tax levied by urban local governments worldwide. It is generally considered to be a good tax for local governments because it is a visible tax financing visible services in the jurisdiction of a city. It is difficult to evade and can promote accountability. The most important disadvantages include high cost of accurate valuation and political difficulty in enforcement. Property tax has not worked well in most developing countries. There are many reasons for this failure. Local governments' inability to fix the difficult administrative challenges of valuation and implementation is mainly responsible for the low yield from property tax. A comprehensive process of property tax reform requires an active role and guidance of the state government. Urban local bodies are required to be engaged

in maintaining databases of properties and reducing the subjectivities in the assessment method. A transparent property tax system where tax payers have all the information and also a grievance redressal system are necessary for an effective tax regime. It would lead to fewer cases of litigation.

Property tax is generally considered to be an appropriate source of raising local revenues as there is a direct connection between the services financed by the tax and the benefit to property values. If property taxes are used to fund local services, it establishes a link between the benefits and costs of local services to the residents. This enables citizens to make efficient fiscal decisions. It is sometimes seen as a tax on capital that distorts the housing market and local fiscal decisions. Property tax based on market value of the land and improvements on it can discourage constructions and can result in underutilization of land. In India in the absence of an organized property market and very low property tax collections, and inadequacy of data related to variables in property market, local finances and local service delivery, it is difficult to assess the validity of the theories that have been advanced in the literature relating to developing countries.

## REVIEW OF LITERATURE

**Anita Rath et al., (2004)** discussed about the context of the clamour for reform in the property tax systems in Indian municipalities. Recent attempts at reform have been based on shifting away from the age-old rental value based system of property taxation. The authors explore the possibility of an alternative capital value based system for a metropolitan city and address the intricacies of a smooth shift-over to the alternative, taking into consideration the pre-reform utility positions of both the property owners and the local government.

**Bowler and Donovan (2004)** identified that in states where voter initiated measures was not a possibility, the number of local government jurisdictions declined. However once a state adopted a TEL, the number of local government jurisdictions in that state increased, more so in states where ballot initiatives were easier to use.

**Bennett and Dilorenzo (1982)** mentioned about the seminal work in the area of property tax limitations and local government borrowing. In their study, the authors show that when state governments imposed restrictions on the taxing authority local governments, these governments responded by establishing Off-Budget Entities (OBEs) that were largely beyond the scrutiny of voters and their expenditures were no longer subjected to the property tax limits.

**Enid Slack and Richard M. Bird (2015)** stated that property taxes are generally considered by economists to be good taxes, and many countries are being advised to increase and improve their property taxes. In practice, however, property tax reforms have often proved to be difficult to carry out successfully. This

paper discusses why property taxes are particularly challenging to reform and suggests several ways in which efforts to reform this tax may become more successful in the future.

**Bird and Slack (2014)** analyzed about the Taxpayers' perceptions of how viable the property tax is and how fairly it is implemented affect the extent to which local governments can raise the tax. There is some evidence that people treat local taxes as essentially prices for local services, an outcome that is on the whole to be welcomed. However, for people to respond appropriately to tax prices, they must be aware of those prices. Strengthening the linkage between local taxes and local expenditures may increase both awareness and support. The reasons for undertaking property tax reform vary over time and across countries: increasing local revenues (and perhaps reducing transfers to local governments), improving local fiscal performance, removing inequities in the tax system so that there is similar treatment of similar properties, reducing administrative and compliance costs by simplifying the tax system, and improving efficiency by reducing the impact of taxes on households and business decisions.

**Garnier et al., (2014)** explained that property tax reform has proved to be difficult in rich and poor countries alike. It has been as hard to achieve in countries such as Greece and Italy, in which little money is collected from property taxes, as it has been in Canada, the United States, or the United Kingdom, in which they are relatively important.<sup>2</sup> In the European Union, for example, although increasing reliance on property taxes was recommended for 11 EU countries in 2014, and nine actually did increase the rate or base of the tax over the 2011–2014 period, revenues from this source did not increase.

**Rosengard, (2013)** elucidated that the property tax is not popular with taxpayers and politicians. It has been characterized as the “tax that everyone loves to hate” and criticized as unfair, because it is unrelated to ability to pay or to benefits received; unsuitable because it supports services that are not related to property; and inadequate because it does not provide sufficient revenue to meet local expenditure needs. It has also been criticized for its negative effects on housing, land use, and urban development. Although the property tax in most countries is levied by local governments, often it is not a truly local tax – that is, one for which the local government decides whether to levy the tax or not; determines the precise base of the tax; sets the tax rate; administers (assesses, collects, enforces) the tax; keeps all the revenue collected; and may grant tax allowances or reliefs to individuals and firms.

**Muellbauer (2005)** revealed that the house-value adjustment impact of property tax assessment can be clarified by capitalization, the backwards interface between house costs, credited lease and the property charge. Property charges are promoted in house costs, i.e. the net present estimation of a house is given by the marked down stream of income (leases) or administrations (ascribed lease) less support expenses and

property charges. As house costs rise, property charges will speak to an expanding offer of rents, in this way decreasing the net present esteem and checking further house value appreciation.

**Norregaard (2013)** identified that Property tax is to adjust the sub-focal expense framework, without changing intergovernmental financial systems. One route forward is to cancel sub-focal property exchange charges, stamp obligations and comparative duties on the exchange of possession, considered destructive for work portability and out of line since the expense does not rely upon the estimation of the property but rather on how regularly it is exchanged.

**Helen F. Ladd and Katharine L. Bradbury (1987)** explored the synchronous connection between impose rates and city property tax bases utilizing information for 86 substantial U.S. urban communities in 1972, 1977, 1982. A 10 percent expansion in a city's property charge rate diminishes the property impose base by around 1.5 percent. Local pay charges and duties required by overlying wards likewise affect the city's property impose base. We presume that duties influence neighbourhood property estimations more than is normally inferred by past examinations that have explored the effects of state and nearby assessments on firms area choices.

**Lall and Deichmann (2006)** determined that the reforms that measure the property tax bases nearer to the market esteem have huge and positive ramifications for income age. In spite of the fact that these reforms are great as an initial step proposed towards more prominent productivity of the property taxes, enhanced valuations and expanding the lightness of the taxes still should be taken a gander at without which changes in tax organization can just yield constrained outcomes. The paper finds that in Pune and Bangalore where the tax evaluations gets connected to the "market rental or capital qualities", there is better prospect of increasing the revenues from property taxes.

**Kelly (2003)** investigated that essential components of property taxation are tax base, tax valuation/appraisal, tax rate(s), tax help, charging, accumulation and implementation. The fundamental idea of these components must be reviewed to give a general comprehension of the political and authoritative unpredictability of property taxes.<sup>24</sup> every one of the property tax components has an impact on the property tax outline and its execution. With a specific end goal to distinguish the change in the property tax execution, an investigative proportion contemplate is fundamental. Hence, Sect. will draw up tax execution pointers that comprise the reason for testing the components and their effect on the tax execution. In light of this, the income preparation demonstrate characterized by is utilized to demonstrate the immediate effect of the single components on the property tax income.

**Pawi et al, (2011)** studied about the major existing issue in property tax gathering is rebelliousness conduct displayed by the taxpayers, which brought about low property tax income age. This provoked the analyst to

examine the explanations behind such activities, in order to decide the nature and reach out of the tenacious issue with a view to proffering a supportable answer for the issue. By the by, a portion of these issues might be related with the tax system/structure. The property tax gathering execution is still under unsuitable level.

**Prest (1962)** endeavoured to make a gauge of the affectability of yield of individual wage taxation as for change in close to home salary in the United Kingdom amid the period from 1947-48 to 1960-61 and found that a substantial extent of any expansion in close to home pay was gotten by those, who were making good on no government expenses or low taxes. This was demonstrated by the way that in 1959-60, a vast extent of individual pay was exempted from tax by the task of different recompenses, and of the extent of the salaries not all that exempted, just 50 for each penny of that were taxed at either the most reduced or the second least rate of tax, though just 13 % of the general population in the higher levels of pay paid surtax on their livelihoods.

**Rose and Karran (1987)** examined that the standard manual for narrating recommends that the most ideal approach to begin a story is with the words "in the beginning" This lead appears to be particularly solid with regards to the advancement of a complex monetary establishment like the property tax, where the name fiscal inertia frequently appears a more fitting portrayal than the term „path dependency“ all the more normally found in the financial writing.

**Zhang Silu et al (2011)** pointed out that from the point of view of property tax value and the advantage got rule, this investigation has examined the effects the family unit enlistment system has on the property tax change of Mainland China and broke down family enlist issues in the property tax change. What's more, this examination has put investigation on the most proficient method to accomplish an even-handed property tax structure, which is extraordinary from earlier investigations.

**Rao (1979)** endeavoured to look at whether Indian tax system was programmed responsive, and which taxes were in charge of it. The examination found that India was more reliant on roundabout taxes. The estimation of in general versatility of the tax system uncovered that it was not sufficiently responsive. Further, it was uncovered that immediate taxes were in charge of laziness of total tax versatility. The low flexibility of different taxes was credited to poor tax organization and convoluted tax methods. The analyst proposed some approaches to change the structure of various taxes.

**Pitchford and Turnovsky (1976)** analyzed the impact of changes in tax rates on expansion by concentrate three sorts of taxes, to be specific, individual salary tax, partnership pay tax, and deals tax. The investigation found that an expansion in any tax would decrease the genuine salary of both, business visionaries and workers, thus prompting an unambiguous deflationary impact through interest. Be that as it may, any wage gathering could pass on some extent of his expanded tax trouble, which would build the expense and hence, there would be an unambiguous inflationary impact. The analysts reasoned that by and large the general

result was uncertain and relied on the relative qualities of interest and cost factors and the level of moving the specific tax.

**Polanyi (1966)** examined the system of taxation of oil creating organizations in Iran, Saudi Arabia, and Qatar. The investigation detailed that the system of taxation was not perfect. The tax was paid at the rate of 50 for each penny on benefit per barrel sold. In any case, if there was any reduction in the costs of raw petroleum in the market, the legislature was not enabling the organizations to diminish their costs since bringing down cost would have influenced their tax income. Be that as it may, the Oil organizations were offering at a value lower than the cost based on which they were taxed. Consequently, the organizations were covering government obligations on notional benefits as opposed to the real benefits which they earned. The creator proposed computation of tax on real benefits as opposed to notional benefits for evacuating such contortions.

**Hicks (1958)** dissected Mr. Kadlor's report with respect to tax reforms in India and valued the proposals made by him. The report proposed presenting four new taxes in India for creating more income, i.e. (I) a tax on capital gain; (ii) a yearly tax on add up to capital or riches; (iii) An individual dynamic use tax; and (iv) a tax on every single unnecessary exchange. The report had additionally proposed a few proposals to enhance the productivity of Inland Revenue office.

**Kaldor (1959)** stated that while inspecting the tax reforms in India, opined that a viable system of dynamic direct taxation is crucial for the survival of popularity based establishments in India. The examination revealed that India made a reasonable begin towards making a viable system of dynamic taxation with the presentation of new taxes on capital additions, riches, individual consumption and endowments. The examination proposed that the most extreme rate of wage tax should not surpass 45 %.

**Somik V. Lall and UweDeichmann (2006)** argued that the property tax is a critical income source in numerous nations; however it is regularly underused as a hotspot for financing neighbourhood uses. In India, numerous nearby governments have started authoritative and valuation reforms to expand the yield from property taxes. In this paper, we look at the financial and distributional ramifications of the progressing and potential evaluation reforms in two Indian urban areas Bangalore and Pune.

**AjitKarnik et al., (2004)** endeavoured that change have been founded on moving far from the deep rooted rental esteem based system of property taxation. The creators investigate the likelihood of an elective capital esteem based system for a metropolitan city and address the complexities of a cover move up to the option, mulling over the pre-change utility places of both the property proprietors and the neighbourhood government.

**Simanti Bandyopadhyay (2013)** explained that endeavours at a near assessment of two Indian urban communities, Delhi and Bangalore, in the execution of actualizing property tax reforms through unit zone technique for valuation and self-appraisal plans. Delhi is where the consequences of usage of these reforms were not up to the stamp though Bangalore could make significant progress. The principle goal of the paper is to clarify the distinctions in the degree of the accomplishment in accomplishing the coveted results in the two urban areas. There has been abatement in number of surveyed properties in Delhi and an expansion in number of evaluated properties in Bangalore. The property tax to GSDP proportion declined in the event of Delhi and expanded if there should be an occurrence of Bangalore. The primary discoveries propose that it is a blend of policy and regulatory elements which are capable to make contrasts in exhibitions of the two urban areas. Ideal progressivity in tax rates, better inclusion and gathering proportions, better administration conveyance, better living conditions and a more steady property advertise are the central point's adding to a superior execution in property tax accumulation in Bangalore.

**Suman (1974)** reviewed that immediate tax as a level of aggregate tax income involved generally more noteworthy significance in the tax structure of created nations. Be that as it may, there significance had been declining and ended up being less versatile wellspring of revenues in immature nations like India. The immediate tax income was 60.8 % of aggregate tax income of USA in 1962-63, though it was just 29.6 for each penny in India around the same time. In the year 1968-69, individual salary tax and enterprise tax contributed as high as 96 % of the aggregate tax income. The creator brought up that lacking taxation of farming area, political contemplations, slow rising of exclusion limits, presence of non-money related division, wastefulness of tax organization, a huge level of tax avoidance and evasion were the fundamental components which had come in the method for successful direct taxation in India. It had been seen that tax avoidance was mostly packed in the upper levels of pay. The investigation proposed that tax laws ought to be made basic, visit changes in wage tax rates ought to be kept away from, and job of direct taxation in asset preparation and decrease of disparities ought to be continuously expanded.

**Jain (1975)** led an experimental examination on taxation of salary in India since 1939 and talked about the premise of tax obligation under different Income Tax Acts. Underscoring the developing significance of partnership tax, the investigation found that the income from organization tax expanded all the more quickly. The creator noticed that farming possessed key position in Indian economy, yet it was not sufficiently taxed. The issues of tax avoidance and tax evasion alongside causes, modes and results were additionally examined and measures to handle these issues were likewise proposed.

**Nor Azriyat et al, (2007)** explained that Property tax is a type of tax collected on property in lieu of the administrations given by the neighbourhood government. This property tax produces a noteworthy extent of neighbourhood government income in numerous parts of the world. It is a type of tax collected on genuine

property that is regularly charged at neighbourhood level for raising the expected income to complete particular formative ventures. Numerous nations have distinctive names for taxes on properties.

**Kuye (2002)** mentioned that the procedure of property tax accumulation includes the assurance of the property estimations by the nearby government through statutory valuation to find out the enhanced estimation of the realty. Additionally, Realty alludes to such property as land or whatever other thing that is for all time appended to the land, for example, landed property.

**Mathur (2001)** analyzed that the organization of property tax includes giving advantage to the legislature and property tax payers. In any case, the advantage of making good on property government expense to the side of taxpayer should be fundamentally recognized identified with the learning and mindfulness on the utilization of income from property tax to the taxpayers. Generally, property tax was required to fund benefits that are obvious, for example, streets, road lighting and cleaning, trash gathering, neighbourhood stops et cetera.

**Pound T (2007)** reviewed on the views of taxpayers, that property tax is associated with the benchmarks which are connected to the customary standards of taxation which include: Fairness in view of advantages got, property taxes ought to mirror the advantages got from government consumptions. Decency in light of capacity to pay, property tax levels ought to be identified with person's capacity to pay regarding both even and vertical value.

**Slack (2005)** mentioned that property taxes should be composed in manners that are effectively justifiable. Clear tax structures give space to policy producers and tax experts to be considered responsible. Simplicity of organization: property tax systems should be straightforward with the end goal that it is anything but difficult to oversee the tax and modest to gather.

**Norhaya Kamarudina et al., (2016)** stated that Property taxation is widespread; it is elusive in a nation which does not demand a tax on its landed property. The best tax policy on the planet is worth little in the event that it can't be actualized successfully. The level of tax yield of property has been underneath the normal tax yield because of appraisal issue. The capacity of valuation is to guarantee reasonable appraisal of property proprietors. This paper inspects the taxonomy of property tax with a view to understanding it piece and review the effect of valuation exactness on property tax from existing writing. The examination uncovers the effect of valuation on property tax, demonstrating the impacts of valuation precision on the measure of tax payable or receivable all things considered. Valuation effect can be seen as being exact or wrong. When it is precise the expense is low for the tax organization, low rate of shirking and avoidance, and arrangement and upkeep of municipal administrations; however the invert is the situation when it is mistaken. The examination suggests that tax specialists ought to connect with qualified experts in the

appraisal of property tax and that administrative body ought to sort out occasional preparing for their individuals.

## RESEARCH GAP

As per the literature survey many studies have addressed the reforms of property tax. Importantly, much of it refers to property tax in India. Some studies have recommended that the tax should be levied by taking family as a unit rather than an individual income. Some studies have found that the source of revenue generation in India has been more from property taxes. Some studies have recommended that principle of 'Ability to Pay' by an individual has generally been undermined in India. Furthermore, the administrative reforms are to control the tax evasion. The reform process in India has curtailed ability of the government to mobilize more revenue especially from property tax. Thus the present study focuses on the Reforming of property tax in Karnataka.

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