

Implementing Local Property Tax

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Cities face major difficulties when attempting to introduce a more efficient property tax system. One such challenge is controlling volatile political issues associated with taxes levied directly on assets, such as the highly visible property tax. The close proximity between the taxing authority and the taxpayer translates into political pressure to reduce taxes and avoid updating property valuations. City officials become an easy target of criticism and may suffer electoral consequences.

Although the property tax is recognized internationally as a preferred instrument to finance urban public services, in most Latin American countries the tax has limited significance as a source of revenue, representing on average 0.32 percent of GDP (De Cesare 2010). Brazilian cities collect an average of about US\$46.50 per capita in property taxes per year. However, most cities do not reach the national average. In more than half of the municipalities, revenues do not exceed US\$5.00 per capita (Afonso et al. 2010).

The Brazilian Property Tax Model

The property tax (IPTU: *Imposto sobre a Propriedade Predial e Territorial Urbana*) is a direct tax paid to the local municipality based on the estimated fair market value of real estate property. In Brazil, much of the potential for collecting this tax is lost because local authorities fail to administer the tax correctly and effectively. Discussions of legislative revisions of the IPTU always result in heated debates and intense political response, in many cases causing mayors and other officials to avoid embarking on the process.

An added problem is the strict legal requirement that valuation criteria must be approved by law before the tax base can be updated. The criteria must include the characteristics of the property and its components, as well as the monetary value attached to each component. In other words, it is not enough for Brazilian legislators to set criteria to determine that one property is more valuable than another and therefore must pay a higher tax.



Photo courtesy of the Municipality of Belo Horizonte (Archive / PBR)

Belo Horizonte, founded in 1897 as the capital of Minas Gerais state, is the first planned city in Brazil.

Reform in Brazil

The law itself must clarify how a property with certain characteristics will be appraised in monetary terms.

After years of debate, Brazil's Superior Court ruled in 1996 that a municipal law would be required to update the IPTU tax base whenever the adjustment is higher than the official consumer price index (Statement 160). Before this ruling, cities used to reappraise the property values for tax purposes by executive acts (decrees), independently of the municipal legislature. Since this legal requirement was introduced in 1996, many local governments chose not to send the necessary bills to the municipal legislature for the much-needed updates of property valuation.

In some cases the resulting political disasters served as an alarming inhibitor to any new attempt to revise the tax base. To resolve this dilemma, several cities opted instead to raise the IPTU tax rates to compensate for their reluctance to reappraise properties. Moreover, for each new law approving an assessment update, new types of exemptions or tax reductions tend to be created, often cancelling the efforts to enhance the performance of the IPTU.

As a result of political resistance, the IPTU was often disregarded as a revenue source for municipal finance in Brazil. The largest cities, with more than 500,000 inhabitants, began to concentrate their efforts on the tax on services (ISS: *Imposto Sobre Serviços*); smaller cities relied more on funds transferred from state and federal government through the municipal revenue-sharing fund (FPM: *Fundo de Participação dos Municípios*) (table 1).

The federal Applied Economic Research Institute (IPEA 2009) reports the loss of IPTU's importance as a share of direct municipal revenues at the national level and the rise in revenues from the service tax—an indirect tax that tends to be regressive. The share of the IPTU in direct municipal revenues decreased from 38 percent to 28 percent between 1991 and 2007, causing it to lose its position to the ISS as the principal source of direct municipal revenue (table 2).

An important change that directly affected the IPTU came in December 2009, when the Ministry

TABLE 1
Composition of Municipal Revenues by Size of Municipality

Population Bracket (1000s of Inhabitants)	IPTU Share in Total Revenue (%)	ISS Share in Total Revenue (%)	FPM Share in Total Revenue (%)
Up to 5	0.5	0.9	51.4
From 5 to 10	1.1	1.5	35.9
From 10 to 20	1.4	2.0	33.7
From 20 to 50	2.7	3.0	25.7
From 50 to 100	4.8	5.0	17.5
From 100 to 500	6.4	7.4	11.7
From 500 to 1000	6.8	8.7	8.4
Over 1000	12.1	15.9	3.6

Source: National Treasury Secretary: FINBRA System (2004).

TABLE 2
Share of the IPTU in Direct Municipal Revenues (%)

Year	IPTU	ISS	ITBI	Municipal Charges	Municipal Welfare Contributions	Other
1991	37.9	27.9	11.2	15.9	2.29	4.93
1992	31.8	31.9	9.32	18.4	1.62	7.12
1993	18.9	44.1	7.62	16.2	2.43	10.84
1994	20.6	41.7	8.30	17.2	5.01	7.26
1995	30.0	36.0	7.09	18.9	5.20	2.77
1996	30.5	38.1	6.66	20.3	4.09	0.37
1997	30.9	39.6	6.41	19.9	2.88	0.34
1998	30.2	39.3	5.64	18.4	5.51	1.02
1999	31.2	37.3	4.94	19.0	7.08	0.56
2000	30.7	38.3	5.29	18.7	6.29	0.79
2001	28.5	37.5	5.81	19.8	6.14	2.21
2002	32.1	39.0	7.02	11.8	9.69	0.39
2003	32.5	38.4	6.34	11.1	11.2	0.40
2004	31.9	40.2	5.96	9.66	11.8	0.47
2005	30.9	43.1	6.20	9.47	9.94	0.33
2006	29.8	45.2	6.62	8.37	9.62	0.33
2007	28.6	47.0	7.01	7.34	9.73	0.33

Note: ITBI is a real estate transfer tax.

Source: FINBRA (Finances of Brazil); data from the National Treasury, processed by IPEA.

of Cities published Resolution Act No. 511 establishing National Directives for the Multipurpose Cadastre (CTM: *Cadastro Técnico Multifinalitário*). This law provided local governments with a valuable standard instrument on which to base their legisla-

tive proposals to update the IPTU tax base. The Lincoln Institute of Land Policy had a major role in supporting the development of the technical aspects of this legislation.

The Resolution Act states that property assessment for fiscal purposes is a technical process that must be carried out according to guidelines from the Brazilian Technical Standards Association (ABNT) to reflect fair market value. It also states that an effective IPTU promotes fiscal and social justice by ensuring equitable treatment of taxpayers. Periodic updating of the IPTU tax base is recommended either (1) every four years for cities of 20,000 inhabitants or more (smaller cities may adopt longer cycles); (2) when the assessment ratio is less than 70 percent or greater than 100 percent compared to the market value; or (3) when cumulative property values are not distributed equally, as measured by a dispersion coefficient greater than 30 percent.

What Prompted the Property Tax Reform?

Combined with a strengthened institutional framework, two other factors have put the IPTU back into the current debate about sources of municipal financing in Brazil. The first was the accelerated appreciation of urban land in both large and mid-sized cities. This appreciation was caused principally by economic growth, the housing credit explosion, low taxation, and low risk compared to investment in financial assets from 2003 to 2007 (Carvalho Júnior 2010). The expansion of the real estate sector exposed the discrepancy between the collection potential and the actual flow of funds into the public treasury from the property tax.

A second factor that unleashed the discussion about updating tax assessments to enhance the performance of the IPTU was the global economic crisis that began in 2008 and reached Brazil in 2009. As economic activity declined, reflecting lower consumption and production and a credit contraction, federal transfers to municipalities declined as well. The cities facing this loss of revenue had little alternative but to revive the IPTU, the oldest and most traditional local tax.

In this context, some of the larger Brazilian cities updated their property value maps with revised land value estimates, as well as the construction cost tables used to assess property values, both of which were extremely undervalued. Belo Horizonte, São Paulo, and Salvador are among the cities that

acted to strengthen their revenues by updating the tax base for the IPTU. These cities also introduced new policies to guide the implementation of the property tax.

It should be noted that to keep the IPTU tax base unchanged is a risk. One of the major sources of tax injustice, along with the problem of omissions in registering land or development areas, is the use of outdated appraisals when imposing the IPTU (Smolka and De Cesare 2009).

The Case of Belo Horizonte

Belo Horizonte is the capital and largest city of the state of Minas Gerais, located in the southeastern region of Brazil. With a population of 2.4 million, it is the fifth largest Brazilian city and the center of a metropolitan region with a population of approximately 5 million.

The local government has a long history of innovation and good governance. It was a pioneer in introducing the participatory budgeting process in 1993, in adopting GIS applications to improve city management, and in carrying out a widely successful campaign to eradicate hunger, among other noteworthy initiatives. Belo Horizonte collected approximately \$332 in property tax per capita per year in 2007, prior to the reform, ranking seventh among Brazil's large capital cities (Afonso et al. 2010).

The property tax reform started in Belo Horizonte with a revision of the tax base and was guided by the dual desire to eliminate distortions created by its antiquated model and to introduce a new fiscal culture that would support a permanent process of updating property valuation to reflect market variations.

The need for additional revenues and the experience of the 2009 financial crisis also influenced the mayor's decision. The subsequent reductions in economic activity and federal transfers convinced the local government that it had to establish more sustainable financial conditions to maintain administrative autonomy. Intensifying the use of the IPTU and convincing the lawmakers of this necessity was the first step on the road to update the property tax base.

In devising a strategy for tax reform, the city government realized the change could not be presented simply as a revision of property valuation driven by the need to increase revenues. It also had to involve other aspects, such as measures to miti-

gate the impact of the tax increase and to provide incentives for taxpayer compliance. Smolka and De Cesare (2009) note that despite the accuracy of valuation estimates, if the reassessment generates large differences in the amount of taxes due, there will be a reaction from taxpayers who are substantially burdened. In this case, plans must be offered that ease such impacts.

The Legislative Process

Once the reform was designed and its virtues and vulnerabilities were identified, the project was submitted first to the municipal legislative council to keep the focus on those empowered to vote and approve the bill. It is a common mistake to seek popular support before or during the voting process, and the executive often loses the battle if it tries to act on two fronts at the same time.

Voting processes in the case of the IPTU are established by municipal law. However, intimate knowledge of the legislative process is necessary, and it is a trump card at the same time. In Belo Horizonte it was important to avoid having either a long, drawn-out process that could leave room for extended questioning or too short a process because an unexpected event could put voting off indefinitely.

Once presented to the lawmakers, all points of the tax reform project were thoroughly clarified. All aspects, positive or negative, were discussed at the council and, of course, favorable aspects were always compared to any noted weaknesses. Legislators must be sheltered from the doubts that are always posed to them and constantly be well-informed and committed to the tax justice criteria embedded in the project. This is the main role of the mayor's representative, a key member of the core group that implemented the reform. As expected, at the end of November of 2009, the project was approved in its second and final round.

The legislative debate on the bill was both an end in itself and a preparation for the public presentation of the project. During the legislative approval process many expectations were created about the reform, especially by the press. From that point on, the strategy was to promote all of the benefits of the new IPTU system of assessment and collection to quell fears until the actual arrival of the tax bill in January 2010.

The Public Information Campaign

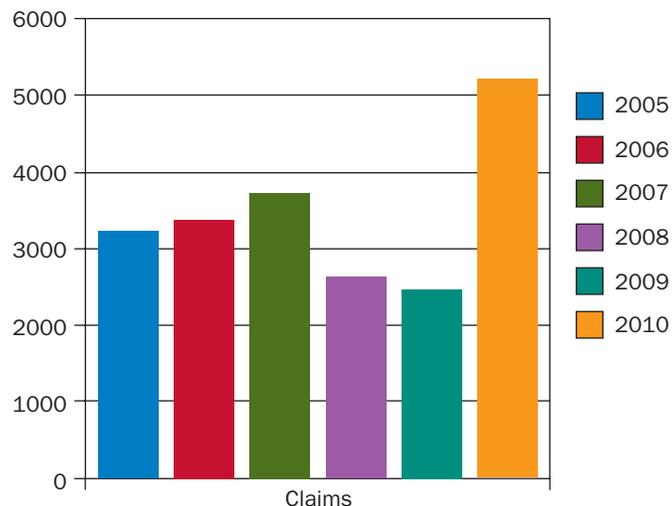
The main instruments used to present the reform to the public were launching a public information campaign and setting up information desks throughout the city to resolve citizen's queries. The next phase implemented the measures intended to mitigate the impact of the reform and to provide incentives for taxpayer compliance.

In the campaign, the administration emphasized the message that all the revenues from the IPTU are used for works that transform people's lives. The goal was to make the benefits of IPTU revenues concrete and visible, and that proved to be an efficient way of showing citizens the practical importance of the tax for the development of the city and for the well-being of its citizens. This message was repeated frequently.

In January of 2010, ten taxpayer assistance desks were operating in different parts of the city. Around 200 municipal staff participated directly in assisting taxpayers in more than 20,000 personal consultations. Of these, 26 percent became requests for review of the tax bill. This number was higher than in 2009, but much lower than the pessimistic expectations of those who foresaw a flood of claims (figure 1).

The overall strategy was to determine how well the situation was controlled, which involved implementing a tax structure compatible with the level of claims expected. Building this structure requires extraordinary foresight and attention to

FIGURE 1
Total Tax Claims by Year in Belo Horizonte



Source: Municipality of Belo Horizonte.



Photo courtesy of the Municipality of Belo Horizonte (Archive /PBH)

Belo Horizonte has more than 3.5 square meters of green area per inhabitant.

soothing the taxpayer and concentrating his attention on what really matters—the correct calculation of the tax and its payment within the timeframe established by law.

However, a good tax structure is not enough. Also important is training staff to provide taxpayer services. Trustworthy, relaxed, quick attention precludes spoiling the quality of the process, the revision of the tax base, and the new tax policies; good taxpayer services also lower the political risks of periodically updating property valuations.

Managing the Process

Among the useful lessons from the Belo Horizonte tax reform process is to avoid updating the tax base only in times of financial crises as an effort to boost revenues. Doing so may undermine the work of instituting accurate valuation practices. Instead, it is advisable to adopt and maintain a permanent updating policy that ensures fairness.

Second, the fairness of the revaluation process should be emphasized in light of the ever-changing market, which imposes price variations that require tax adjustments. Consumption taxes are indiscriminate as to the taxpayer’s economic condition and have a regressive effect, whereas IPTU permits progressive rates and thus helps to improve equity, which in turn improves access to housing, contributes to municipal autonomy, and leads to efficient city planning. Instead of relying primarily on indirect taxes or federal transfers, the municipality that uses the property tax efficiently can reduce

social inequalities and better order urban spaces, while also avoiding speculation and helping to preserve the environment (IPEA 2009).

A third important point is to establish clear channels for discussing the reform plan. Preferably, policy steps should be taken by a trusted representative of the mayor who is authorized to negotiate on his behalf through a democratic and collective process. Belo Horizonte established a core group with one person named to coordinate what information will be disclosed and how it will be discussed with the public.

A misunderstanding of the process can create insurmountable resistance and place the complete project in jeopardy. Thus, a key factor is having a well-informed press agent who is capable of dealing with the criticism and inquiries that will surely come, as well as a technical person who knows the reform project well and can offer the explanations required by the different actors in the process.

Property Tax Relief Measures

Belo Horizonte succeeded in achieving its goal through arguments for justice and administrative autonomy that culminated in the approval of a complete revision of the property tax system, including the following relief measures.

- *Tax rate reductions.* These were introduced after updating the tax base to avoid a tax burden beyond the capacity of the taxpayer to pay.
- *Adjustment of the progressive tax.* The city also introduced graduated tax rate brackets consistent with property values, effectively replacing what had been, in practice, a single tax rate.
- *Expansion of the exemption value threshold.* This would correct for the fact that, in a dynamic real estate market, many older properties or those belonging to lower-income owners would be priced out of the IPTU exemption band once the revaluation is completed. To avoid this situation, the threshold was raised for property values exempt from the tax.
- *Spreading the impact of the reform over two fiscal years.* Even for taxpayers who have the capacity to pay, an increase in the IPTU could cause an imbalance in their personal budgets because of other financial commitments. Thus, the city allowed payment of half of the increase in 2010 and the full amount in 2011.
- *Deferred payment.* Special circumstances, such as unemployment, illness, or prior debt, can affect

one's ability to pay the property tax. The reform established that a taxpayer who demonstrates conditions of duress could request the postponement of a portion of his tax until 2013.

- *Creation of discount programs.* One of the objectives of the tax reform in Belo Horizonte was to make the IPTU a tax that promotes redistribution of income and contributes to a higher quality of urban life. Thus, the city offers tax discounts in exchange for citizen's participation in social, health, education, and economic development programs that foster development.
- *Discounts for early payment.* The annual IPTU in Belo Horizonte can be paid in eleven equal installments, due on the 15th of each month between February and December. Taxpayers who make a minimum of two installments by January 20 receive a 7 percent discount for pay-

ing in advance, and historically a large number of taxpayers chose this option. These advance payments guarantee sufficient revenues to meet financial commitments in the beginning of the fiscal year, which runs from January to December.

Evaluating the Results

The final part of the reform is to verify the results. In Belo Horizonte, this evaluation confirmed the success of the entire planning and implementation process, and is a source of information for future improvements. This success can be measured in part by the increase in early payments, which illustrates taxpayer acceptance of the model. Table 3 compares increases in numerous measures from 2009 to 2010, and table 4 compares increases in IPTU revenues for the first six months of both years.

TABLE 3 Results of the 2010 IPTU Reform in Belo Horizonte Compared to 2009			
	2009	2010	Variation (%)
Number of properties taxed	679,626	687,736	1.19
Total revenues assessed	R\$627,580,715.62	R\$744,701,235.66	18.66
Exemptions granted based on property value	55,087	96,195	74.62
Number of taxpayers making discounted payments¹	351,362	391,496	11.42
Revenue received in advance in January 2010 (R\$)²	R\$259,432,033.95	R\$328,670,247.90	26.69
Percentage of total revenues paid in advance	44.42%	47.45%	6.82
Number of taxpayers paying the tax in January 2010³	281,654	291,562	3.52
Total discount given to taxpayers who paid in advance	R\$19,346,644.04	R\$24,702,781.16	27.69

Notes: 1. Discount granted for prepayment in January, as well as other types of discounts. 2. Includes public services taxes collected along with the IPTU (trash collection, for example). 3. Payment discount is granted for prepayment of at least two of the eleven tax payment installments.

Source: Municipality of Belo Horizonte.

TABLE 4 Increase in IPTU Revenues, First Six Months of 2009 and 2010							
Fiscal Year	Revenue Collected from the IPTU (R\$1,000)						
	JAN	FEB	MAR	APR	MAY	JUN	JUL
2009	241,142	21,059	20,000	19,233	19,491	19,362	21,034
2010	278,179	26,650	24,239	24,021	24,231	23,365	23,735
% Change	+15.36	+26.55	+21.20	+24.89	+24.32	+20.67	+12.84

Source: Municipality of Belo Horizonte.

TABLE 5
Points to Observe in Planning a Strategy for Revision of Land Value Maps

Project Development	Voting on the Project	Public Presentation of the Project	Assistance	Process Evaluation
Identifying flaws in the prior model	Estimating voting time	Maintaining unique technical standards to clarify doubts	Creating a comfortable service structure	Comparing results
Encouraging political involvement of public authorities and creating work coordination groups	Maintaining the necessary approval base		Training specialized personnel to provide information and receive claims	Identifying structural flaws and proposing corrective measures
Developing a performance strategy for the approval of the reform	Supplying information necessary to convince legislators	Investing in publicity showing investment of revenues collected	Maintaining computational systems, monitoring risk, and immediately correcting flaws	Searching for mechanisms to permanently ensure quality control and fair market value data
Creating a mechanism to compensate tax increases and protect economically deprived sectors				

Nevertheless, all of these achievements can be lost over the long term if certain conditions are not met. One such condition is to institutionalize the periodic updating of property values used to

calculate the property tax. This is critical since the strategic planning for this reform was motivated precisely by the long period during which the Belo Horizonte land values map had remained unchanged, creating discrepancies from actual market prices and eroding city revenues.

A second condition is to create mechanisms that both guarantee the technical quality of tax assessments and relieve the local government of the political burden of performing the necessary updates. The objective is to make the updating procedure a legal obligation of a technical nature instead of a political decision.

Another option considered was the creation of an assessment committee to perform mass valuations coordinated by municipal authorities. Such a committee would bring together collaborators from entities that operate in the real estate market, such as brokers, builders, private assessors, or financing entities. This measure could help to mollify the political overtones that permeate the property tax system and develop property reassessment programs that rely on participants instead of critics.

Belo Horizonte’s successful experience (albeit with room for improvement) can serve as a reference for other cities that expect to update their property cadastre and their guidelines for mass assessment. Table 5 outlines some of the issues to be considered. □

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