

Toward More Effective Property Tax Systems in Latin America

As part of its ongoing education program in Latin America, the Lincoln Institute, with the Porto Alegre (Brazil) City Council, organized the “International Seminar on Property Taxation” in April 2001, to discuss equity and efficiency in property tax administration. More than 200 delegates came from 12 countries, 14 Brazilian states and 45 local authorities. Internationally recognized experts and public officials in government, academia, public finance and taxation represented such institutions as the Inter-American Development Bank (IDB), the International Property Tax Institute (IPTI), the International Association of Assessing Officers (IAAO), the Brazilian Association of Secretariats of Finance of Capitals (ABRASF) and the Brazilian School of Fiscal Administration (ESAF). This article draws on the issues and experiences discussed at that seminar.

CLAUDIA M. DE CESARE

As in the United States, there is an ongoing debate in Latin America over the replacement of the property tax with alternative revenue sources, such as fees and charges, that might be easier to administer, less influenced by political factors and more efficient. Nevertheless, the property tax remains the predominant option for raising revenue to finance public services at the local government level in Latin America.

An important characteristic of the property tax is the great diversity found in its administration. For example, the property tax is a purely local tax in Brazil, Colombia and Ecuador, but it is administered at the province level of government in Argentina. In Mexico, the role of the local authorities has been reduced to primarily tax collection. In Chile, the property tax is an important revenue source for local governments, although the central government is responsible for administering the cadastral, assessment and collection systems. El Salvador is the only country in Central America that has never introduced the property tax, although currently there is strong pressure for establishing new taxes, since tax revenue represents only about 11 percent of GDP.

Insights on Property Tax Administration

In general the property tax is recognized as a ‘good tax’; its role is essential in the process of recovering revenue, funding



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Speakers at the property tax seminar in Porto Alegre included (left to right) the Mayor, Tarso Genro; the City Council President, Luiz Fernando Záchia; Martim Smolka of the Lincoln Institute; and José Eduardo Utzig, Secretary of Finance of Porto Alegre.

public services and promoting social development. The unique nature of the property tax provides important links among wealth and income, social development, and land use and occupation. However, the property tax must be administered fairly to avoid inefficiency and inequity in the distribution of the tax burden. Concerns mentioned in several seminar sessions included the need for an adequate cadastre, as complete as possible in terms of coverage and containing basic attributes needed for assessing different types of properties. One discussion group recommended integrating the community in the continual process of updating cadastral data. Others emphasized the need for performing a careful cost and benefit analysis before implementing geographic information systems.

In countries where the cadastre is not administered by the central government, there is no standard model or system. Depending on the development level of the municipality and/or financial resources available, the cadastre technology can vary enormously from a simple list of properties to a cadastre based on a geographic information system with multiple purposes. Diverse valuation approaches are also observed: self-assessment is used in Colombia and Bolivia, whereas the cost approach is commonly used in Brazil, Chile, Ecuador and Mexico. Some local authorities in Brazil are engaged in a movement to use the sales comparison approach for residential property. In applying the cost approach, the land value is determined using the sales comparison approach. Although based on market information, the land value is

also estimated in different ways, causing concerns over how to reduce assessment inequities.

Valuation is primarily a technical task that requires assessment uniformity and short valuation cycles, and should not be used for political purposes. Capping systems, which limit tax increases between consecutive periods for each individual property up to an overall adjustment based on annual inflation rates, are seen as a major source of assessment inequity. Transparency in the valuation results is considered fundamental for guaranteeing the taxpayers' confidence in and acceptability of the tax system. Other basic premises include fiscal accountability, fairness, democratization of information, and translation of technical language into a form that is understandable to community members and leaders. Furthermore, community members should take part in making decisions on public revenue collection and expenditures.

A recent development of interest in this regard is the increasing use of Internet facilities by taxpayers to receive and pay tax bills, review statistical data on their property and update cadastral information. Chile is considered the benchmark in Latin America in the use of these technologies.

Experiences with Fiscal Reform

Several seminar presenters shared their experiences with property tax reform and revisions, which often include investments in cadastral systems. For instance, the improvement in the collection performance of the property tax in Colombia increased as a percentage of GDP from 0.22 percent in 1970 to 0.91 percent in 1994. This improvement was attributed in part to legislation that demanded the implementation and updating of the cadastre throughout the country. The strong pressure against updating assessed values, as well as administrative difficulties in undertaking valuations, resulted in the establishment of a self-assessment procedure. Taxpayers are now responsible for declaring the assessed value of their properties, but the value cannot be less than the recorded cadastral value. To reduce underassessment, the

Number of Inhabitants in Brazilian Cities	less than 10,000	from 10,000 to 100,000	from 100,000 to 200,000	more than 200,000	Brazil total
Current Revenue					
Revenue from property tax	6.24	10.04	20.30	39.74	23.07
Revenue from other taxes and fees	10.33	16.45	36.97	91.49	49.11
Tax transfers from:					
• Central Government	166.77	76.69	42.51	22.89	58.02
• State	97.53	80.42	108.44	130.11	105.17
• Voluntary contributions	46.34	32.56	34.43	34.44	34.60
Capital Revenue	331.14	224.29	255.20	346.76	286.46

Note: R\$(Reais) is the Brazilian currency. In 1996 R\$ 1 equaled approximately US\$ 1.

assessed value is also used as the basis for expropriation.

Fiscal reform initiatives in Argentina during the 1990s were strongly motivated by financial crises in the public sector. The reform project relating to the property tax was divided into two main areas, cadastres and fiscal administration. The equivalent of over US\$ 120 million has been invested in these reforms, yet the project has been completed in only about 50 percent of the jurisdictions. In another example, Mexicali, the capital city of Baja California, pioneered the adoption of land value as the property tax base in the 1990s. Although this was a successful experience with property tax reform, current challenges in Mexico include achieving fiscal balance between public expenditure and revenue raised and recovering the importance of the property tax as a revenue source.

Property Taxation in Brazil

Political, legal and practical obstacles have contributed to the continuation of inequities and inefficiencies in the property tax in Brazil. Frequently there is no common interpretation of tax regulations among major branches of government (the judiciary, legislature and executive), creating a pervasive lack of confidence in the tax system. Primary concerns in property tax administration include incomplete and out-of-date cadastres, resulting in irreplaceable losses in revenue; poor assessment practices that generate a low degree of uniformity; the strong influence of historical assessed values, because valuation is infrequent

and approval of a new valuation list in the Chamber of Councilors is often difficult; and low performance in tax collection.

The validity and feasibility of adopting progressive (sliding) rates for the property tax, largely used in Brazil during the 1990s, was reexamined. The basic idea had been to establish progressive rates according to classes of assessed value and to insert an element of ability-to-pay into the system, simultaneously making high-value properties pay more proportionally and alleviating the tax burden on low-value properties. In 1996, the Supreme Court declared the use of progressive rates for the property tax unconstitutional. However, a recent constitutional amendment authorized progressivity in the property tax rates based on the value of properties, as well as different rates based on property location.

Arguments expressed in the seminar against the application of progressive rates for the property tax were based on the principle of keeping the tax simple, and concerns about the measure's effectiveness. Arguments in favor of progressivity included the concentration of income disparities in Brazil and the fact that the poor are likely to spend more proportionally in housing expenditures than are the wealthy. The majority of seminar participants believed that the progressive rates might promote a fairer distribution of the tax burden. However, progressivity should be gradual; that is, a higher rate should be applied only over the part of property value that exceeds the limit established in each

class of assessed value, to avoid a large difference in tax burden for properties with values slightly above and below the boundaries of each class.

At the national level in Brazil, inefficient use of the property tax as a revenue source is widely recognized. Revenue from property taxes represents less than 0.4 percent of GDP. Indeed, the tax actually collected is only symbolic in many parts of the country. A recent survey of municipalities investigated several aspects of local government performance, including tax evasion. In only 13 percent of the municipalities was the tax evasion rate less than 20 percent. In one out of five municipalities, the revenue collected represented less than 20 percent of the properties included in the cadastre.

Table 1 demonstrates the relative importance of property tax revenue in Brazil, according to the size of the municipality. Small municipalities are financed largely by transfers from other government levels and larger municipalities are more dependent on the property tax as a revenue source. However, the performance of property tax administration depends directly on political will, which varies enormously among cities. For instance, due to an extensive updating of its cadastre, the city of Santana de Parnaíba, with 60,000 inhabitants in the State of São Paulo, collects approxi-

mately R\$ 212.00 per inhabitant, while the average revenue collected from property tax for cities of its size (10,000 to 100,000 population) is R\$ 10.04 per inhabitant. That performance is even better than in São Paulo, the capital of the state, which collects less than R\$ 80.00 per inhabitant. Similarly, a participatory approach involving local community and nongovernmental organizations (NGOs) allows critical issues of property tax assessment and administration to be discussed, resulting in actions to improve the system. In the city of Ribeirão Pires, for example, measures that increased revenue by 40 percent included an ample review of the property tax legislation that allowed the adoption of better assessment practices, new property tax rates and more efficient procedures for tax collection. Furthermore, the tax reform has contributed to increasing the local government's popularity.

Case Study of Porto Alegre

Inspired by the April seminar and previous research and analysis, the local government of Porto Alegre has prepared a proposal for a property tax reform aimed at increasing fiscal equity, enhancing the importance of the property tax as a revenue source, and creating more efficient administration of the tax. The project was presented on September 28 to the City

Council, the entity in charge of either approving or rejecting the measures, which must be decided before the end of 2001. A multidisciplinary project team was composed of local authority members, such as valuers, property tax experts, and urban and environmental planners, as well as a group of statisticians and information technology experts from the Federal University of Rio Grande do Sul. The measures being proposed have been discussed thoroughly with representatives of public associations, community leaders, the media and city councilors (See Table 2).

Conclusion

The participation of several hundred delegates at the seminar is evidence of the importance of property taxes in their countries. Although there is still an ample need for improving the overall performance of property tax systems, the debate demonstrated progress in the way the tax is administered and perceived in many parts of the region. Several independent experiences made it clear that political will is the principal element for explaining differences in the performance of property taxes in Latin America. Recent technological advances, now accessible to any country, have been able to provide better solutions in data management, valuation and assessment. Challenges are gradually moving from the technical to the political sphere. More than ever learning how to implement tax reforms and revisions is essential for pursuing more effective property tax systems. A trend toward using a participatory approach when undertaking such revisions is also evident, since public acceptance is likely to facilitate the reform process. **L**

CLAUDIA M. DE CESARE is a property tax advisor to the Secretariat of Finance for the municipality of Porto Alegre, Brazil. She also conducts research and teaches courses on valuation and property taxation at the Federal University of Rio Grande do Sul and the Lincoln Institute. She is a member of the advisory board of the International Property Tax Institute (IPTI) and is active in other professional organizations. Contact: cmdecasare@smf.prefpoa.com.br

TABLE 2 Major Areas of Proposed Property Tax Reform in Porto Alegre

General valuation: Mass appraisal techniques and current data on property sales are used to improve assessment performance. Assessment bias that causes either over- or under-assessment of certain classes of properties is being reduced.

Provision of tax relief to properties used for agricultural purposes and timber production: The provision aims to provide economic incentives to preserve agricultural activities and timber production in urban areas. The properties affected by the regulation are being identified and classified.

Provision of tax relief to historical buildings and properties in environmental preservation areas: The provision aims to make available economic incentives to preserve current land use and avoid environmental degradation. These properties also are being identified and classified.

Progressive rates according to classes of assessed values: An empirical analysis of the link between taxpayers' income and property values, as well as the impact of the proposed measures on the distribution of the tax burden, was undertaken to orient decisions on the rates established in the proposal.