# Improving the Equity Component of the Lagos State Land Use Charge (2018) for Enhanced Property Tax Yields

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## ABSTRACT

*Property tax has remained a subject of recurrent debate amongst policy makers, scholars, public officials, real estate valuers, and other stakeholders, virtually everywhere over the years. The contention centres on issues such as the tax base, tax incidence, efficiency, and particularly, equity or fairness, among others. Qualities like ease of collection, difficulty of avoidance, accountability, and transparency etc., that ordinarily mark out property tax as a good tax in principle, are often compromised by controversial policies and mal-administration, particularly the latter. The new Lagos State Land Use Charge2018 (LUC, 2018) came into force effective January, 2018. Ina similar version that its immediate predecessor, the Land Use Charge2001 (LUC, 2001), attracted spontaneous and widespread protests on promulgation, the criticisms and protests that greeted the passage LUC (2018)has been vehement and remained unabated until the government was forced, like it did with the erstwhile law, to succumb to substantial but arbitrary reductions in rates and allowances across board (at two different times to date) but without a formal amendment to the law; an exact replica of what transpired under the erstwhile law and which opened it to abuse and arbitrary implementation with its compliance and revenue yields implications. The last of these reductions which took place in August saw a whopping 50%, and 25% cut in assessed rates on commercial properties and industrial properties, respectively. This study employed the doctrinal research methodology whereby the valuation or assessment aspect of the LUC (2018) was diagnosed with a view to finding amicable resolutions to the equity problem that virtually crippled the effectiveness of LUC (2001) over its seventeen years of existence and is already threatening the survival of the new LUC (2018).*

***Keywords:*** *assessment criteria, equity and fairness, Land Use Charge (2018), property tax.*

## INTRODUCTION

Property tax is an annual tax on real property. It is usually, but not always, a local tax. Property tax has been in existence for at least three millennia. It is common throughout the world and has often been the subject of political debate. At the local government level, property taxes can be considered one of the most popular options for raising revenue for financing public services. In this context, property taxes are defined as an annual tax on land and buildings. Some well-known characteristic of property taxes perhaps account for its universal popularity in integrating taxation systems. Among others, property tax is considered easy to understand and enforce. It is cheap to collect and administer, difficult to evade, capable of producing a large and predictable yield, and easy to allocate to a particular local authority in terms of revenue. In addition, it represents a familiar concept to local administrators as well as taxpayers. Furthermore, property tax is a tool for encouraging local democracy while allowing the public sector to derive shares of private sector windfall gains from public investment in infrastructure (Slack, 2013). A well-executed property tax system ensures a stable revenue source for local administration that enables a long-term provision of essential services (Lincoln Institute of Land Policy, 2017).

In spite of its widely acknowledged revenue generation potentials, property tax has not yielded appreciable revenue in most countries, particularly in developing countries, Nigeria inclusive. The World Bank (1995) described property tax as the largest untapped potential source for municipal infrastructure in Nigeria. Ali, Fjeldstad & Katera (2017) reported that in many African countries, property taxes raise revenue far less than 0.5% of the gross Domestic Product (GDP) against over 2% average in developed countries. In fact, in the UK and France, property tax revenues account for over 4% of GDP (OECD, 2016). Babawale & Nubi (2011) reported that in Nigeria and other West African countries collection rate is as low as 10% of potentials.

Tax, everywhere, is generally abhorred and history is replete with spontaneous nationwide protests against new tax policy or mere tax rate adjustments in several countries, developed and developing, including countries like UK and a number of states in the US. Property tax, is particularly resented. Property tax is strongly criticized due to the inequities present in current systems; because it usually involves bulk payment; while assessment bias is identified in the tax base estimates. Furthermore, its visibility and direct impact; its tendency to be regressive; and the fact that it falls on unrealized capital gains and may be poorly related to cash flow, are other often cited drawbacks. The strongest drawbacks in property taxation system are perhaps those related with the tax base assessment.

Tax, however, must be paid to finance economic activities. Economic development thrives on the provision of basic government services and a higher rate of capital formation in production facilities. While there are many constraints to the delivery of these basic requirements in developing countries, the most universal and crucial is finance. Local resources including foreign grants, aids and loans, have proven insufficient and have continued to decline (Babawale, 2013). The developing countries, therefore, have to do what the developed countries have to do in their individual history, i.e. call on the citizens to make sacrifice. Taxation is central to the required sacrifice. Without a more rigorous and realistic tax policy, the economic development process of developing countries will be seriously impeded. In the developed countries, an average citizen has come to accept taxes as the price to pay for civilization. This is not so yet in the developing nations where it is generally regarded as an oppressive imposition or, at least, a necessary evil. Property tax is particularly more generally disliked by taxpayers because, among others, it confronts taxpayers directly with the cost of providing urban services. Policy makers likewise detest property tax especially because it attracts an unusually high political sensitivity within the tax structure. According to Kitchen (1992), due to their high visibility, property taxes are subject to extensive pressure because unfairness, inefficiency, and administrative problems are clearly perceptible. In fact, the most usual assessment bases adopted, i.e. the real estate market values, rental values, and site values, are not related directly to ability-to-pay. As a result, where local authorities have access to a less efficient but more politically tolerant revenue sources, these tend to be exploited first (Dillinger, 1991). Non-accountability and poor administration, failure to provide those essential services for which rates are collected, brazen corruption among local government officials in the areas of rate assessment and collection, and the tendency to employ property tax rates as a weapon against political opponents, are other major reasons why property tax is detested in certain quarters (Babawale & Nubi, 2011).

## Equity in Property Taxation

Since people generally view taxation as a necessary evil, economists over time, beginning with Adam Smith, have laid down certain principles (cannon of taxation) that provides guides to policy makers when drafting tax laws in order to minimize the pains to tax payers and thereby improve compliance and revenue yields. The principles which include equity or fairness, certainty, convenience, economy, productivity, elasticity or flexibility, and diversity; remain the diagnostic criteria for assessing tax policy and administration; they remain the universal hallmark of sustainable and efficient property tax system, anywhere till date. The concept of equity, in particular, remains a fundamental doctrine in taxation. Otubu (2017) opines that the equity principle transcends the other principles as it encompasses them all one way or the other. From ancient civilizations, particularly in the Greek and Roman Empires up until colonial America, equity in land taxes has remained a contentious issue (Carlson, 2014), while

Norregard (2013) wondered why the consideration of equity or fairness remains a long-standing and contentious issue for a tax as ancient as the property tax.

The terms 'equity' and 'fairness' are often used synonymously in tax literature. Equity is a synonym for tax fairness (IAAO, 1997). However, from the perspective of property taxation, a distinction is necessary. According to Woolery (1989), "fairness' generally relates to the legislation upon which the tax is promulgated which often specifies whether different types of property are to be taxed at different rate or percentages of market value or whether different groups of 'taxpayer' are to be given some form of preferential treatment, such as reliefs, rebates or exemptions. The fair share principle in taxation is built on the two concepts of the benefit principles and the ability-to-pay principles. The benefit principle subscribes to the view that tax burdens are to be shared or distributed in the same proportions as the benefits derived from government; whilst the ability-to-pay principle anchored on the premise that highest taxes should be levied on those with the highest ability to pay.

'Equity' or 'assessment equity', on the other hand, is a measure the quality of property tax system administration in terms of assessed values. An equitable tax system is "a system of assessment and taxation characterized by uniformity, equality and just valuation based on property wealth". Lack of equity has been universally recognized as a principal clog in the wheel of efficient and effective property tax system with serious implications on compliance and revenue yields buoyancy. The ability-to-pay concept is based on two measurable constructs: horizontal equity and vertical equity. Both of these constructs have an important bearing on the actual distribution of the tax liability, ignoring any tax reliefs, etc. (IAAO, 1997).

## Horizontal Equity

In public finance, horizontal equity is the idea that people with a similar ability to pay taxes should pay the same or similar amounts. It is related to the concept of tax neutrality on the idea that the tax system should not discriminate between similar things or people, or unduly distort behaviour. The principle of horizontal equity provides that two identical properties of the same value should have the same assessed value. That is, similar properties in a given jurisdiction should share equal tax burden. For example, if a property has an assessment value: sales price ratio of 0.80, it would be expected that comparable properties' assessment values: sales prices ratios to be near 0.80. The standard measure for horizontal equity (fairness across comparable properties) is the coefficient of dispersion (COD). The COD is calculated by finding the average of all absolute deviations from the median in percentage terms. In measuring the level of assessment, the IAAO recognizes the difficulty of perfect horizontal equity. The standard is a 15 % range around the jurisdiction median assessment ratio in areas where housing type is diverse. The standard acceptable COD is 10 percent for areas where the housing type is similar in age and design (IAAO, 1999). A COD of 15% means that properties have ratios that on the average deviate by 15% from the median ratio.

## Vertical Equity

The principle of vertical equity states that two properties having the same value should be assessed equally or that a property that is twice the value of another should have twice the assessed value. For example, if the assessed value of a N100 million property is N90 million (0.90 ratio), then assessed value for a property having a market value of N200 million is expected to beN180 million or thereabout (0.90 ratio).Vertical inequities can either be regressive, where high-valued properties are under assessed relative to low-valued properties; or progressive, when the opposite holds true. Concerns about local tax systems have centred more on the vertical equity issue and on the possibility that local taxation might be regressive, that is, low-income residents pay a greater percentage of their income in local taxes. The price-related differential (PRD) is a common measure for vertical equity. PRD is an index that is centred on the number one or unity. It is calculated by taking the overall mean assessment-sales ratio of a jurisdiction and dividing it by the sum of assessment divided by the sum of sale price (weighted average).

According IAAO standards for quality assessment, a PRD index between 0.98 and 1.03 is the acceptable standard (IAAO, 1999).

## The Role of Valuation in Property Tax Assessment Process

The role that valuation plays in the overall property tax system is to assist the system in distributing the tax burden logically and objectively amongst taxable properties thereby contributing to the equity of the system. The larger proportion of the equity problem in property tax therefore arises from the assessment process and the quality of the resultant assessment. Assessment equity in property tax measures the degree to which assessment bears a consistent relationship to market value for all properties at the assessment date. There is perfect equity when the ratio between assessed value and market value is constant across properties in a given tax jurisdiction. Assessment bias occurs when some classes of property have a ratio of assessment to value significantly different from the ratio of others in the same taxing jurisdiction (IAAO, 1978). Where the assessment process is less than efficient, the quality of other aspects of the tax administration is invariably compromised. Inaccurate assessment jeopardizes the fairness of the tax system, diminish its ability to raise adequate revenue, and create economic distortion, among others. For example, if a parcel is under-assessed relative to comparable parcels, the owner of under-assessed property will pay *less* than his/her "fair share" in taxes. On the other hand, if a parcel is over-assessed relative to other properties, that owner will pay more than his/her "fair share". It is the failure of the valuation process to attain horizontal and/or vertical equity that invariably brings the tax system into disrepute with far-reaching consequences. Inaccurate assessment aggravates both vertical and horizontal inequities, encourage corruption with all attendant consequences in terms of tax avoidance, evasion, delinquencies, appeals and resultant poor revenue yields. Lack of equity creates poor revenue yield due to non-compliance, reduced tax base, public resistance as taxpayers to lose confidence in the system, and avoidable payment delays. Since the assessment process and quality of assessment is the foundation of the property tax system, valuation becomes the root from which all other components of the property tax can be accurately evaluated. Accurate valuation of the tax base is therefore central to successful property tax system.

**Critical Tax Assessment Decisions affecting the Equity of Property Tax System**

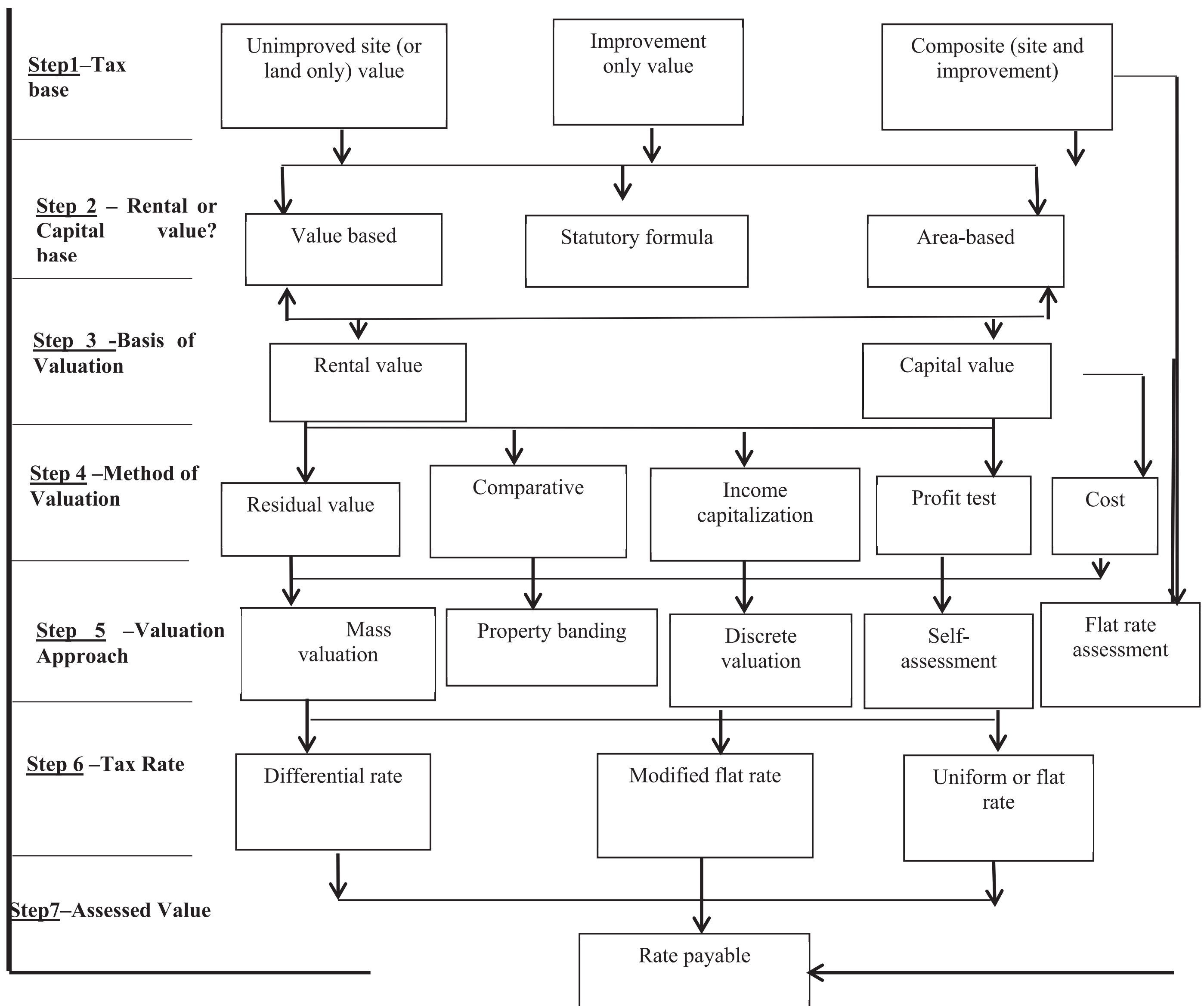


Figure 1: Alternative Property Tax Valuation Process/Models

Figure 1 outlines seven major steps in the process for assessing property tax. Each of the steps requires key decisions which ultimately determine the equity of the tax system. They are:

i) whether the tax base or the object of taxation should be land only, improvements only or a combination of land and improvements.
ii) whether the basis of valuation should be value-based, area-based and/or by a statutory formula;
iii) whether the assessment should be based on capital value or rental value;
iv) whether the method of valuation should be cost, or comparative, or income capitalization, or profits or accounts, or residual, or flat rate assessment;
v) whether the approach to valuation should be discreet (property-by-property) valuation, or property banding, or mass valuation, or by self-assessment;
vi) whether the tax rate should be uniform or flat rate, differential rate or a mix of flat and differential rates.

The seventh, which is not part of Figure 1 is whether the method of re-valuation (when it is due) should be complete property-by-property re-valuation, or mere rate adjustment, or by indexation.

It follows that the way and manner these components are specified and combined ultimately determines the efficiency of the tax system and its revenue yields potential. According to Byrne (1996), models should adequately represent the problem structure, simple and easy to understand, capable of unequivocal objective interpretation, flexible and involving minimum calculation while satisfying the economy of time, cost and resources.

The goal of this paper is to identify the aspects of the valuation process in the new Lagos State Land Use Charge (LUC) 2018 that pose the greatest threat to equity and consequently compliance and proffer alternative approach to circumvent the clog while enhancing the simplicity, transparency, cost effectiveness of the valuation process, as well as the potentials for improved compliance and tax revenue yields.

## The Lagos State Land Use Charge Law, 2018

The Lagos State Land Use Charge (LUC) 2018, like its immediate predecessor, the Land Use Charge 2001 (LUC, 2001), represents a radical and wholesome restructuring of the entire erstwhile land-based tax system in the state. Prior to the 2001 reform intervention, land-based tax in Lagos State has evolved into a complex system of three different taxes, rates and charges administered by different agencies and at different levels of government. These included the Land Rates Law, the Neighbourhood Improvement Charge Law and Tenement Rates. When a new Land Use Charge was announced, there was a high expectation that the new law (LUC, 2018) was being contemplated apparently to build on gains of erstwhile reform (LUC, 2001) and probably to plug loopholes and redress certain policy and administrative inadequacies or contradictions. Commenting on LUC 2001, Babawale & Nubi (2011) noted that "the protest that greeted the passage of the LUC 2001 was loud, vehement and spontaneous, cutting across all stakeholders as well as all sections of the general public.

The Nigerian Institution of Estate Surveyors and Valuers (NIESV), the Nigerian Bar Association (NBA), the Chartered Institute of Taxation of Nigeria (CITN), among professional bodies and the organized private sector (OPS) have particularly attacked the law on various grounds describing it variously as outrageous, vexatious, objectionable, draconian, unrealistic, spurious, ill-conceived, uncivilized, retrogressive and a breach of democratic ideals, among others. The OPS, the major stakeholders and a number of its numerous affiliated bodies have dragged the state government to court challenging various aspects of the law. Major Nigerian newspapers have run series of editorial commentaries on the law advising the Lagos State Government to give the law human face and tread the path of negotiation and dialogue with the stakeholders.

The Lagos Millennium Group on the Environment, an NGO, called on its members to disregard the law." The latest intervention (LUC, 2018) which is probably intended to smoothen the rough edges in the 2001 law seems to head the same way as the former in what turns out to be a more provocative and controversial provision.

## Assessment Process Under LUC, 2018

The tax or charge is calculated as follow:

(Land Value + Building Development Value) X relief Rate X Charge Rate

Interpreted as:

**LUC** = M x [(LA x LR) + (BA x BR x DR) X RR X CR]

Where,

**LUC** = annual amount of Land Use Charge in Naira.
**LA** = the area of the land parcel in square metres.
**LR** = the average Market Value of a land parcel in the neighbourhood, on per square metres basis in Naira based on the market value of the property as determined by professional Valuers appointed by the commissioner for that purpose.
**BA** = the total developed floor area of building on the plot of land in square metres, or the total floor area of apartment unit in a building where the apartment has a separate ownership title.
**BR** = the average construction value of buildings and improvements in the neighbourhood or a per square metre basis in naira based on the market value of the property as determined by professional Valuers appointed by the commissioner for that purpose.
**DR** = the Depreciation Rate for the buildings and improvements of the land which account for the building being of higher or lower value than the average buildings in the neighbourhood and which also account for the degree of completion of construction of the building.
**RR** = the rate of relief from tax (if any) applicable to the Owner Occupier in the circumstances shall be determined by the commissioner and shall be published in the State Government Official Gazette and in one or more newspaper circulating within the state and reviewed by the Commissioner once every five years.
**CR** = the annual charge rate expressed as a percentage of the assessed Market value of the Property and which may, at the State Governor's discretion vary between (a) Owner-occupied and other Property; (b) residential Property and Commercial (revenue generating) Property; (c ) Physically challenged persons; and (d) persons who have been resident at the same location for at least twelve years, minor, and retired Owner and Occupier, on the one hand, and other Owners and Occupiers on the other.

Table 1: Land Use Charge Annual Relief Rate

| S/N | Item | | Annual Relief Rate | Remarks |
|---|---|---|---|---|
| 1 | General Relief | | 40% | Applicable to all properties liable to pay Land Use Charge |
| 2 | Specific Reliefs (Applicable in Property Owners and Lease of 10 years and above). | | | |
| | I | Pensioner | 100% | Owner Occupied – 60 years & above |
| | II | Persons and disability | 10% | Owner occupied |
| | III | Aged Persons | 10% | Owner Occupied – 70 years & above |
| | IV | Age of property | 10% | 25 years and above |
| | V | Long occupation by Owners | 5% | 12 years and above |
| | VI | Federal and other State Government Properties | 20% | None Revenue Generating |
| | VII | Partial Relief under the land use charge law | 20% | None profit making |
| 2b | The onus is on a person seeking a Specific Relief to provide relevant documents in proof | | | |
| 3 | Payment within 15 days of receipt of Demand Notice | | 15% | timely payment discount |
| 4 | Mode of Application for relief | | All applications for relief must be made to the Commissioner for Finance for approval supported with relevant documents. | |
| 5 | Minimum Land Use Charge | | ₦5,000.000 | No Property liable to Charge shall pay a sum less than ₦5,000.00 (Five Thousand Naira irrespective of any relief granted. |

The annual land use charge rates to be applied to eligible properties in Lagos State shall be as follows:

Table 2: Land Use Charge Annual Rate

| | | |
|---|---|---|
| A | Owner-Occupied Residential Property | 0.076% per annum of the Assessed Property Value |
| B | Owner-Occupied Pensioner's Property | Exempted from Land Use Charge |
| C | Lagos State Government Properties | Exempted from Land Use Charge |
| D | Industrial Premises of Manufacturing Concerns | 0.256% per annum of the Assessed Property Value. |
| E | Residential Property (Owner and 3rd Party) | 0.256% per annum of the Assessed Property Value. |
| F | Residential Property (without owner in residence | 0.76%of the Assessed Value; |
| G | Commercial Property (Used by occupier for Business Purposes) | 0.76% of the Assessed Value; |
| H | Vacant Properties and Open empty Land | 0.076% per annum of the Assessed Value. |

That is, the LUC, 2018 provides for a modified area-based mass valuation using the cost approach. The contrived statutory formula produces an undefined value (howbeit, erroneously referred in Section 10 of the law as the 'market value of the property'). The choice of mass valuation over discreet valuation (property-by-property valuation) is also in line with modern property tax practice. In mass appraisal, the ordinary principles of real estate valuation apply. However, unlike in the conventional valuation procedure where individual property is inspected and measured, market information is collated on individual property basis, and the property is valued discretely; mass valuation is based on extrapolation of data collected from samples of comparable properties. The valuation approach is based on the

rationale that properties that exhibit similar value-determining characteristics in the same or similar location will have the same value. Among other benefits, mass valuation approach is cheaper, simpler and administratively more convenient as it relies on few market evidences for interpolation; reduces room for Valuer's discretion; computer-assisted mass valuation can be quite accurate, particularly when used in a homogeneous area, there is also evidence that they are not accurate in other instances such as when the appraised property does not conform well to the neighbourhood; mass appraisal can greatly reduce the time to complete a value estimate.

The choice of area-based assessment over value-based assessment is also a welcome reform measure in a sense. Area-based assessment also has considerable benefits over value-based assessment for certain categories of properties where the market evidences are not available in the right quality or quantity or both. Among others, it is cheap and simple to introduce and manage and attracts little argument because of the factual nature of the tax base, thereby obviating the need for high level technically-and professionally-skilled valuation staff and eliminating the need for costly collection and analysis of market data; has the ability to operate effectively in the absence of an active, healthy and comprehensive property market as is the case in many developing countries including Nigeria. The merits of the strict area-based technique have been grossly compromised and tainted by the so many arbitrary and baseless modifications introduced into the contrived formula leaving it without form or standard.

However, the crux of the controversies that greeted and continue to trail the Land Use charge 2018 and similarly its immediate predecessor, the Land Use Charge 2001, centres principally on the choice of 'capital value' assessment over the rental value assessment; while the latter is generally considered to be more appropriate, pragmatic, objective, transparent, logical and equitable. It is commonly believed that if this singular controversy is appropriately addressed and redressed, all other misgivings about the law will fade into thin air.

## Capital Value or Rental Value?

The choice between rental or capital value assessments vary from country to country and the choice has largely been dictated by administrative feasibility and, in particular; the type, quantity and quality of available transaction data. According to McCluskey &Bell (2008), the choice between 'capital' or 'rental' value is hinged upon market data and taxpayer perception. The argument is that there must be a strong correlation between the form of market data evidence and property tax system. Thus, in countries where majority of property is held in leasehold (a dominant rental market) the focus should be on rental value; however, where the property market is dominated by high levels of owner occupation, freeholds and sales, the focus should be on capital or sale value. The latter is particularly true of countries where the mortgage system (home ownership rather than home renter) is reasonably developed and the property market relatively active so that transaction evidences for sold property is amply available in the open market more than rental evidences (particularly, for housing which represents the bulk of property stock in any city or village). In such countries, the capital value is further de-capitalized to arrive at the annual rental for purpose of arriving at the rateable value because the ultimate basis of assessment is invariably the annual value, net or gross. Whereas, in countries like Nigeria, where the mortgage system is epileptic and poorly developed so that the property market is dominated by renters more than owner-occupiers, the direct rental basis is more apt and preferred.

In theory, there ought to be no differences whether the capital or the rental value is used. Provided a property is put to its highest and best use and is expected to continue to do so, rental value will bear a predictable relationship to market value as the discounted net stream of rental payment will be approximately equal to market value. However, this relationship does not always hold for two main reasons, among others. First, gross rents are often used rather than the economically relevant "net" rents that build in an allowance for maintenance expenditures, insurance costs, and other expenses. Second, most countries tend to assess rental value on the basis of current use rather than the best and highest use.

Whatever may be economic consequences between using rental and capital value basis, what is essential is a tax valuation system that is objective and transparent; that is politically creditable and administratively feasible thereby eliminating or at least minimizing opportunities for dispute or collusion; and a methodology that is appropriate to local skills and the market information that is readily available within the tax jurisdiction. Ideally, the tax burden should be distributed amongst all tax payers de jure and de facto, according to the ability of individual to pay (Sulija & Sulija, 2005). The feasibility and viability of any taxation system generally depends on the perceptions and the level of acceptance of the process and its underlying basis by taxpayers. Successful application of any property tax system in a cost-effective way requires a pragmatic tax administration procedure and a friendly tax administration environment.

## What's ideal for Lagos State?

For Lagos State, the rental value option is more appropriate and equitable, and obviously provides more transparent and objective basis of assessment compared to the area-based/cost/statutory formula basis prescribed by the law for a number of cogent reasons including:

i) Property tax is a tax levied against the deemed value or against the income arising from property, rather than against an individual or a legal entity;

ii) Since property tax is an annual charge then the tax ought to be paid from income flow rather than wealth (a stock); it is more appropriate to tax the net rental value obtainable than the capital value. Moreover, it is easier for an average tax payer to relate readily more with a property tax assessed in proportion to the annual rent accruing from the taxed property than the capital value or any other value definition. For the taxing authority, tax assessed on the basis of annual income rather than capital value, makes it easier to appreciate when the assessment is getting beyond a reasonable proportion of the earning capacity (annual) of the taxed property;

iii) It is a universal principle that tax burden should be distributed amongst all tax payers de jure and de facto, according to payers' abilities to pay rather than "highest and best use" of the property. The application of rental value provides a more direct and incontrovertible relationship between the tax and 'ability to pay', while eliminating the need to introduce arbitrary deductions, depreciation allowances and ratios which render the assessment process under the new law rather artificial and highly subjective thereby making it susceptible to human errors and deliberate manipulations.

iv) All over Lagos State, the market for annual rent (rather than sale value) is relatively active, and indeed active enough to provide adequate evidences required for an *ad valorem* tax, at minimum cost. The annual rent passing on different classes of property (particularly residential property which represents the bulk of property stock) in most parts of the state is a common knowledge or can easily be imputed by over 400 firms of Estate Surveyors and Valuers dotted across the length and breadth of the state; whereas the capital value market is thin and opaque.

v) The calculation of 'capital value' using the contrived formula introduces a number of subjective and contentious variables/parameters into the assessment model; making it highly artificial and highly manipulative; thereby resulting in ultimate assessments that are spurious, inconsistent, and therefore controversial. The value produced by the formula remains undefined; and has no foundation or meaning both in theory or practice. It therefore remains logically indefensible!

vi) Assessment on the basis of annual rent involves virtually no 'valuation' thereby eliminating all controversies surrounding the choice of valuation method, rate of depreciation, and other arbitrary deductions or allowances. All that is required is an average annual rent passing on each category of rateable properties in each neighbourhood thereby administrative minimizing costs considerably.

vii) Rates assessment via capital value overlooks the fact that annual return on property is one of the lowest in the investment markets ranging from as low as 4.5% for prime residential properties to 8% for purpose-built industrial properties. It is indeed the growth potentials that makes property to be preferred above some alternative investments. Unless the policy takes cognizance of this truth which is more apparent where the rental basis is used, instances where properties are taxed

beyond their potential annual incomes, as was alleged under the LUC (2001) and is already resurfacing under LUC (2018), is inevitable.

viii) The rental value assessment obviously satisfies the canons of taxation i.e. equity (or fairness), certainty, productivity, flexibility, diversity, productivity, economy and simplicity more than the capital value assessment and particularly the Area-based cum Statutory Formula as provided by LUA (2018).

ix) Ability to pay depends on the value of the property. However, the assessment under LUC (2018) using the contrived formula produces neither the rental nor capital value; the 'value' produced is in fact undefined and therefore lacks consistency, rationality, and of course, equity.

x) On the whole, the annual rent basis improves the transparency and simplicity of the tax system; it is more cost-effective and promises higher potential for compliance and revenue yields buoyancy.

## How the Rental Value Basis Works?

For property tax purposes, the rental value can be assessed on gross annual value or net annual value basis, usually the former. When the gross annual value is calculated, allowances are made for necessary outgoings to arrive at the net value as the rateable value. The enabling statute may provide specific lump sum or a percentage allowance for outgoings (landlord's cost of repairs and insurance and other expenses, if any, necessary to keep the hereditament in a state to continue to earn its annual income) as statutory deductions. For example, a uniform 20% may be allowed to cover these costs across board making 80% of the annual rent receivable the rateable value. To the Net Annual Value (NAV) or rateable value figure is then applied the rate nairage (that may vary between categories of properties) as determined by taxing authority to arrive at the rate payable.

### Illustration 1

(1) A 4-bed room wing of duplex in Gbagada which currently let for N2,500,000 will be assessed as follows:

| | |
|---|---|
| Annual rent | N2,500,000 |
| Less allowance for landlord's outgoings @ 20% | 500,000 |
| Net Annual Value (NAV) | 2,000,000 |
| Applicable rate @ 5% | x 0.05 |
| Therefore, rate payable | N**100,000** |

### Illustration 2

A block of 8 Nos. 3-bedroom flats in Ikoyi which currently let for N5,000,000 per flat i.e. a total of N40 million for the whole block will be assessed as follows:

| | |
|---|---|
| Annual rent | N40,000,000 |
| Less allowance for landlord's outgoings @ 20% | 8,000,000 |
| Net Annual Value (NAV) | 32,000,000 |
| Applicable rate @ *5% | x 0.05 |
| Therefore, rate payable | **N1,600,000** |

*Rates ranging from 3.5% to 5% of NAV would be ideal and should generally be acceptable. Taxpayers should be willing to pay this range as tax given that a higher proportion of property values are created by government expenditure on infrastructure and services.

## For Specialized Properties

For highly specialized properties that are rarely traded in the market for lease or sale, a strict area-based (no artificial formula) can be adopted. Under a strict area-based assessment system, a charge is levied per square meter of the land area or per square meter of building area, or some combination of the two. Assessment therefore results in a tax liability that is directly related to the size of the land and building (s). The assessment rate may be the same for land and building, or it may be different; for instance, a lower unit value per square meter might be applied to building to encourage development, for instance.

### Illustration 3

(1) An eatery built on a land area of 1000 square metres and providing a gross floor area of 250 square metres may be assessed as follows (assuming assessment rate for this category is 1% for land and 0.4% for improvement)

| | | |
|---|---|---|
| Land area: 1000 m2 @ N10,000 | N10,000,000 | |
| Building area: 250 $m^2$ @ N75,000 | N18,750,000 | |
| | | |
| **Rate payable calculations:** | | |
| Land: N10,000,000 @ 1% | N100,000 | |
| Improvement: N18,750,000 @ 0.4% | 75,000 | |
| Total property tax payable | | **N 175,000** |
| | **OR** | |
| **De-capitalized to obtain the rental value:** | | |
| Capital value of the property (land & improvement) | N28,750,000 | |
| Average yield on Eateries say, 6% | 0.07 | |
| | | **2, 012, 500** |
| Less allowance for landlord's outgoings @ 20% | 402,500 | |
| Net Annual Value (NAV) | 1,609,500 | |
| Applicable rate @ 5% | x 0.05 | |
| Therefore, rate payable | | N**80,475** |
| | | **Say, N80,500** |

### Illustration 4

(1) The industrial premises of Alberny Nig. Ltd., a manufacturer of a brand of Instant Noodles, covers a total area of approximately 10,000 $m^2$. Out of this, the main factory occupies 1,500 $m^2$, the 2 Nos. office blocks on single floor occupies gross area of 380 $m^2$ and 450 $m^2$, respectively; the staff canteen occupies a gross floor area of 110 $m^{2;}$ while the Security/Gate house/Store covers 48 $m^2$. Construction rates are as follows: N180,000/ $m^2$ for the factory; N150,000/ $m^2$ for the offices; N75,000/ $m^2$ for the canteen; and N60,000/ $m^2$ for the gatehouse/store. Again, assessment rate for this category of property is 1% for land and 0.5% for building.

| | |
|---|---|
| A - Land | |
| Total land area: 10,000 $m^2$ @ N10,000 | 100,000,000 |
| | |
| B - Improvements | |
| Main Factory: 1,500 $m^2$ @ N150,000 | 225,000,000 |
| Office blocks: 450 $m^2$ + 380 $m^2$ = 830 $m^2$ @ N150,000 | 124,500,000 |
| Canteen: 110 $m^2$ @ N75,000 | 8,250,000 |
| Security/Gate house/Store: 48 $m^2$ @ N60,000 | 2,880,000 |
| Total for improvement | N360,630,000 |

**Rate payable calculations:**

| | |
|---|---|
| Land: N100,000,000 @ 1% | N1,000,000 |
| Improvement: N360,630,000 @ 0.5% | N1,803,150 |
| Total property tax payable | **N2,803,150** |

**OR**

**De-capitalized to obtain the rental value:**

| | |
|---|---|
| Capital value of the property (land & improvement) | N360,630,000 |
| Average yield on Eateries say, 6% | 0.08 |
| | **28, 850, 400** |
| Less allowance for landlord's outgoings @ 20% | 5,770, 080 |
| Net Annual Value (NAV) | 23,080,320 |
| Applicable rate @ 5% | x 0.05 |
| Therefore, rate payable | N1,154,016 |
| | **Say, N1,150,000** |

## CONCLUSION

Equity theory of motivation in management states that individuals are motivated by fairness, and if they identify inequities in the input or output ratios of themselves and their referent group, they will seek to adjust their input to reach their perceived equity. Thus, the higher the individual perception of fairness, the greater the motivation level and vice versa. This theory which has its focus on employees' motivation in the workplace is, in many regards, equally relevant to property tax administration and particularly to improving tax compliance by improving taxpayers' equity perception of the tax system. A critical element in the successful implementation of property tax reform is support from tax payers. Such support is more likely if taxpayers both feel that they are receiving adequate services for the property taxes that they pay and if they perceive that the process is fair and accountable (Bird and Slack, 2002). Nothing undermines citizens' confidence than an inequitable tax policy. An arbitrary and discriminatory tax policy, administered haphazardly and prejudicially will only breed opposition and non-compliance; it will also lead to loss of faith and confidence in the elected representatives, retard the development of civic responsibility and endanger the democratic process. Contemporary policy makers are well reminded that tax payers perception of insufficient exchange equity and lack of representation in tax decisions were part of the triggers for the American Revolution and similar revolts in history across the globe. Taxpayers must have a positive perception of exchange equity.

Empirical and anecdotal evidences over the years and over the world confirmed that mere tax reform does not guarantee as sustainable system or improve revenue yields unless the tax system is realistically, equitably and judiciously designed and administered. They must be satisfied that in the long run, they are getting their commensurate services for the taxes they pay. In the words of Bird & Oldman (1990):

*"The best approach to reforming tax in a developing country – indeed in any country – is one that takes into account taxation theory, empirical evidence, and political and administrative realities and blends them with a good dose of local knowledge and a sound appraisal of the current macroeconomic and international situation to produce a feasible set of proposals sufficiently attractive to be implemented and sufficiently robust to withstand changing times, within reason, and still produce beneficial results."*

## RECOMMENDATION

The biggest administrative problem with property taxation is the assessment. First, this requires technical skill which, in most developing countries including Nigeria, is often in short supply, thereby necessitating the need to engage consultant valuers with its high cost of execution implications. Second, the process often involves a high degree of personal judgment and of contact between assessors and taxpayers which offers wide temptation to collusion particularly, undervaluation. Other delimitating factors include the prevailing attitudes towards anything called tax and poor level of logistic and technology including human factors. Valuation is an inexact science. In particular, property tax valuation process need not aim at achieving very high valuation accuracy, provided the procedure adopted guarantees objective, equitable, transparent and consistent results. According to Ratcliff (1972), fairness, not accuracy, is important in the levying of property taxes. To minimize distortion and inequity, it would also be necessary to standardize techniques and procedure into rational, equitable, and comprehensive system to minimize the subjectivity of the system and possibility of manipulation including revenue leakages. As such, countries, particularly developing and emerging countries where property market is still largely immature and transaction data in short supply, are encouraged to imbibe simplified valuation systems which limit site visits to physical measurement combined with application of standard formulas, perhaps with the aid of computer, may be more effective. In addition, being an annual tax, property tax should ideally be an *ad valorem* tax to improve the equity of the tax system. It is easier for both the taxing authority as well as the tax-payers to relate to the assessment based on the annual income receivable on a property than on its capital value. Assessment based on capital value may

cause the taxing authority to, wittingly or unwittingly, levy taxes in excess of the annual returns on property investment, thereby negating capital formation necessary for economic development and unwittingly pushing away the much-needed funds from the property sector particularly, the housing sector, to other sectors.

Finally, no one enjoys paying taxes or charges, but there are differences in the degree of acceptance or resentment which affect the intent to which people actively seek to avoid their obligations. Compliance can be encouraged in several ways including simplicity, transparency and the fairness of the assessment process, among others.

Given this peculiar property taxation environment; simplicity, fairness, transparency, explain ability and cost-effectiveness become the watchwords in designing appropriate valuation models for developing economies (Kelly & Musunu, 2000). These are universal hallmark of effective, efficient and sustainable property tax system. To maximize fairness and understandability in the property tax system, assessments should be based on current market value of property, and, for a place like Lagos State where the rental market is more active and open than the market for property sales, the annual rental value basis would be more pragmatic besides being far more equitable. The assessment process proffered by this study (see illustrations 1 – 4), which is anchored on annual property values, is no doubt, more transparent, simple, logical, objective, rational, consistent, cost-effective and particularly equitable. In particular, the assessment process eliminates the arbitrariness associated with the assessment formula prescribed by the law under review such as the allowance for accrued depreciation, general and specific reliefs, and the annual charge rates. Given effective coverage, efficient collection strategies, commensurate service delivery and a minimum revenue leakage; the rate payable, as assessed for typical examples illustrated above, should be fair to taxpayers and should suffice as an annual charge for a mega city that is in dire need of active private sector partnership in housing (including other categories of property development) to meet the alarming and ever-increasing gap between supply and demand.

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