An Overview of Factors Affecting Property Tax Revenue Generation in Local Governments in Malaysia

Muhammad Akilu Umar, Rozilah Kasim & David Martin
Faculty of Technology Management and Business
Universiti Tun Hussein Onn Malaysia, 86400, Parit Raja, Batu Pahat, Darul Taazim, Johor, Malaysia.
akilumahmad78@gmail.com, rozilah@uthm.edu.my, martin@uthm.edu.my

Provision of facilities and delivery of strategic services to improve the quality of life the people living in the sub-urban communities is an imperative issue to municipal councils. However, property tax revenue generation is affected by certain factors, which tend to have an effect on the amount of property tax revenue generated. The aim of this paper is to review the factors, which affects property tax revenue generation. On the other hand, the taxpayers are very observant, if there are no commensurate provisions of facilities and services they avoid paying the property tax with the believe that, the revenue generated is not effectively utilized. Therefore, key to improving the property tax revenue generation is by resolving these issues, which will inevitably promote regional development.

Keywords: Property Tax, Facilities and Services, Revenue Generation, Public Goods, Tax Compliance.

Introduction
Local governments serve as a link between the government and the people living in rural communities in terms of public goods delivery. Goods produced by the government are referred to as public goods; these goods can be used up by more than one person, it is produced for the benefit of the society (Miller, 2006). Some public goods are excludable, while others are non-excludable (Miller, 2006). Excludable public goods are those that people can be able to exclude themselves from using them, like roads and schools. One can choose the roads to used or to avoid, school to take your children can also be selected but a person cannot avoid non-excludable public goods like services: environmental waste control, defense, waste management, landscaping. These are mostly strategic services offered by the public authorities using the revenue generated from property tax.

The revenue generated from property tax is used in the delivery of basic infrastructures like electricity, water supply, environmental waste management, pollution control among others. Thus, it is anticipated that local governments is to generate funds to foster growth and development to complement constitutional allocation (Kuye, 2002). However, if the generated revenue from property tax is not prudently utilized in providing efficient public goods, this tends to create tax resistance. Fjelstad, (2001) has summarized the reasons for resistance from taxpayers as;

i) Taxpayers see few tangible benefits hence property tax perceived to be unfair.
ii) Poor development activities
iii) Absence of public service and enforcement increase tax resistance.

In a municipal area where taxpayers are observant it is imperative for the local government to step-up their services and infrastructural provision to the community in order to create a tax friendly environment.

An Overview of Property Tax in Malaysia

Property tax is imposed to finance the construction and maintenance of public facilities such as public toilets, bus stops, children's playgrounds, parks, public places, construction and maintenance of infrastructure such as roads, sewers and drain, provision and maintenance of street lights. Mohamed (1998) support this and states that the major functions of Malaysia local authorities can be summarized as environmental, public, social and developmental. The Local Government Act of 1976 provides local
authorities in Malaysia with a very comprehensive set of functions and responsibilities. Two other main laws, the town and Country Planning Act (1976) and the Street, Drainage and Building Act (1974), help local governments to perform their functions under the 1976 Act. These Acts allow the local authorities to assume more developmental functions in the field of urban management and play a more dynamic role in national development. These roles are:

a) Environmental control; this relates to functions of maintenance and improvement of the environment within the area of jurisdiction. This includes obligatory services such as cleansing, collection and disposal of solid wastes, proper drainage and sewage, sewerage system and beautification programs.

b) Provisions of public amenities; this applies to services such as abattoirs, veterinary services, transportation, burial grounds and crematoria.

c) Provisions of Public health; this function includes the provision of sanitation and solid waste management system, cleaning drains and roads and the general upkeep of the environment. The licensing of hawkers, stall holders, shop and business operators whose businesses are public nuisances and obnoxious in nature, falls under this function as well.

d) Social functions; some larger municipalities provide social services such as child care centers, clinics within their health care service program ambulance other services. Besides these, they maintain fountains and arrange for lighting public streets and other public services and provide manual labor and facilities to state governments or the district offices to assist in the organization of ad hoc social services at the state and district levels.

e) Developmental functions; as opposed to mandatory functions of the local authorities, the development functions are considered "discretionary" under the Local Government Act, 1976. Even though local authorities could be regarded as an important instrument for local socioeconomic modernization, the lack of financial and physical capacity limits the extent and functions that they can provide. This is particularly the case with district councils. In the face of rapid growth and the pressure to fulfill multiple needs of the local citizens and the private sector community, the scope of functions and responsibilities of local authorities is expanding every day.

The increase in the rate of industrialization, trade, commerce and development of modern services is not only pushing the demand for urban space but also that of urban support services. Increase in concentration of people and industries in urban areas the functions and responsibilities of local authorities to have significantly expanded. According to Mohamed (1998), local authorities in Malaysia to perform multifarious roles that include:

a) Efficient service delivery functions and employment generation;

b) The normal system maintenance function for public places, drainage and sewerage, market places and crematorium, road maintenance and street lighting, landscaping and maintenance, public health and sanitation;

c) The development planning and control and management functions (building control, land-use planning, development, creation of industrial estates etc.)

d) The promotion of tourism and urban renewal beautification program; infrastructural development and support facilities which could facilitate industrial development and other locally-based economic development initiatives.

Ismail (1995) stated that the major source of revenue is the assessment rates which accounted 47 percent of total revenue for a local government in Peninsular Malaysia. Rateable hereditament is a holding which is subject to the payment of a rate made and levied under the Local Government Act, 1976 (Act 171), the interpretation is even if it is a bare site without any form of development or the land is attached to a building. According to Section 2, Local Government Act, 1976, holding means any land, with or without buildings attach to it, which is held under a separate document of title and in the
case of subdivided buildings, the common property and any parcel of it in the municipal council, the holdings which are categorized into rateable holdings. These categories are as follows:

a) Land attaches with building such as housing, low cost house, terrace house, shop lot, factory or office on it
b) Vacant land
c) Agriculture land with buildings
d) Quarry

The property tax revenue is generated from these holdings. Some researchers think that rates of a falling proportion of local authority income with other taxes through government grant system providing an increasing share of the resources. (Hepworth, 1980). This statement is not true because property tax represents a sizeable portion of local government resources. Part V, Section 39 of Local Government Act 1976 state the revenue of a local government shall consist of:

a) All taxes, rates, rents, license fees, dues and other sums or charges payable to the local authority by virtue of the provisions of this Act or any other written law.
b) All charges or profits arising from any trade, service or undertaking carried on by the local authority under the powers vested in it.
c) All interest on any money invested by the local government and all income arising from or out of the property of the local government, movable and immovable.
d) All other revenues accruing to the local government from the government of the federation or of any State or from any statutory body, other local government or from any other sources as grants, contributions, endowments or otherwise.

An Overview of Factors Affecting Property Tax

In any country equity and fairness plays an important role. Equity and fairness are essential elements of property tax system. Wenzel, (2004) suggested three areas of fairness from the taxpayers’ point of view are social psychological in nature.

1) Distributive justice (viewed as the exchange of resources that is benefit and cost).
2) Procedural justice (viewed as the process of resource distribution).
3) Retributive justice (viewed as the appropriateness of sanctions when norm-breaking occurs).

In distributive justice, an individual is concerned about the fairness of his actions, and wants to be treated in relation to his merits, efforts and needs (Kirchler et. al., 2008). If he feels that his tax burden is higher than other people within the same income group, his tax compliance probably decreases more widely at group levels; taxpayers want a fair treatment of their group relative to other income groups. If a specific group perceives that their tax liability is higher than other groups, then tax evasion might occur among the group members (Spicer and Becker, 1980). At the society level, tax compliance is less likely occur but if the perception is held that the tax system is unfair, wide scale tax evasion is likely to take place (Allingham and Sandmo, 1972; Barjoyai, 1987). In contrast, if the society perceives that the tax system is equitable and fair, voluntary compliance is expected to increase.

With regard to procedural justice, the main elements for perceived fairness are neutrality of procedures used, trustworthiness of the tax authorities, and the polite, dignified, and respectful treatment of taxpayers as individuals or groups (Tyler and Lind, 1992). It is argued therefore that increased information about tax law and regulations can increase fairness perception and compliance (Wartick, 1994). Retributive justice, unreasonable and intrusive audits and unfair penalties lead to stressful and dissatisfied taxpayers (Spicer and Lundsted, 1976). Unfavorable retributive justice
perceptions could lead to non-compliance (Allingham and Sandmo, 1972; Barjoyai, 1987). In contrast, if the society perceives that the tax system is equitable and fair, voluntary compliance is expected to increase.

**Empirical Evidence on Determinants of Tax Compliance**

Theoretically, there is evidence suggesting tax compliance is influenced by numerous factors (Brook, 2001; Alm, 1999). Scholars identified these factors as economic, social and psychological factors (Jackson & Millron, 1986; Fischer, 1993; Alm, 1999; Brook, 2001; Kirchler, 2007; Devos, 2008). To tackle the challenge of tax noncompliance, it is necessary to understanding factors influencing individual’s decision to comply with provision of tax laws. The early researchers based their work on economic perspective of tax compliance and they identified tax rate, penalty and detection probability as factors influencing taxpayers’ behavior (Allingham & Sandmo, 1972).

In the course of time, researchers realized that taxpayers’ compliance behavior is equally influenced by psychological and social issues this provide the basis for carrying out research in these areas (Fischer et al., 1992; Bobek, 1997; Wenzel, 2004; Manaf, 2004; Jabbar, 2009). Similarly, taxpayer social background affects his thinking and conduct and invariably his compliance (Akilu et, al. 2013). However, comprehensive review on tax compliance by Jackson and Millron (1986) identified 14 key factors influencing tax compliance. Fischer et al. (1992) categorized these key determinants into four group constructs and it became known as Fischer’s Model of tax compliance. This model consists of tax system structure (tax rate, penalty, and probability of detection, complexity of tax system); noncompliance opportunity (income level, income sources and occupation) and demographic factors (age, gender and education); attitude and perception (fairness, ethics, and peer influence).

Major considerations on taxpayers’ attitudes and perceptions to tax compliance are the fairness of the tax system and peer influence, this is part of Fischer’s model. It is widely believed by tax administrators and the taxpayers that growing dissatisfaction with the fairness of tax system is the major causes for increasing tax noncompliance. However, Porcano (1984) finds that taxpayers’ need and ability to pay are the most significant variables related to perceptions of fairness of the tax system. Thus, unfairness of the tax system may reflect taxpayer’s perceptions that they are overpaying taxes in relation to the value of the services provided by government or in relation to what other taxpayers pay. If the whole system is misconceived or negatively perceived, then there might be resistance in tax compliance.

**Conclusion**

Conclusively, in countries like Malaysia the taxpayers’ perceptions, differences in income, different levels of education and different ethnic groups regarding tax payment may cause variation in compliance behavior in different parts of the country. Chan and Leung (2009) also observed that, Culture is considered as a powerful environmental factor that affects the taxpayer’s compliance. It is argued that people are likely to be willing to pay local taxes where the amount they contribute can relate to services received (Livingstone & Charlton 1998) & (Westergaard & Alam 1995). The study concluded that taxpayers observe the state of affairs in terms of facilities and services provision. Therefore policies should be tilted towards adequate delivery such facilities and services aspired by the residents of the area. Facilities and services delivery process by the local government should incorporate the community to create awareness on projects under execution and further strengthen the relationship between the people and the local authority. Similarly, Community-based skills are an addition to the professional skills key requirement for organizational success (Kasim 2011). Taxpayer education is also essential in the study area. These proposed recommendations might assist in improving the property tax revenue generation capacity of the local government.
REFERENCE:


