Property Tax Revenue Generation Reform as a Tool for a Sustainable Local Government in Malaysia

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Abstract

Tax collection in the Local Governments in Malaysia has been a recurring issue due high rate of arrears in property tax revenue generation. As reported by the Economic Report of the Ministry of Finance, the revenue collection in Local Governments throughout the country showed an alarming decline. The current challenge is how to increase the revenue base of Local Governments through property taxation. Similarly, recent study has shown that the low income generation from property tax has resulted in the reduction of expenditure due to persistent increase in budgets allocations. Most significantly, recent studies reveal that there have been a persistent problem of declining property tax collection generation in Malaysia. Therefore, the aim of this paper is to review problems associated with low property tax revenue generation in Malaysia. This paper explores reasons for the prevailing decrease in property tax collection generation, through investigating the Taxpayers expectations from the property tax generated by the local government. More so, the paper discovers that the taxpayers expect a lot from property tax collected. The implication of the study is that it concentrated measures taken to ensure property tax compliance, but not service delivery, while on the other hand it may increase the revenue generation of the local government. Moreover, it is only through a reform of the property tax collection may improve low revenue generation in Local Governments.

Keywords: Property assessment, Local Government, Property tax collection reform Revenue Generation

1. Introduction

Property tax is generally practice by countries around the world, sharing this view is Dzulkanian (2008) stated that almost all governments around the world rely to some extent on property taxation. Similarly, in municipalities of United States, Canada, and Australia, property tax is the major source of revenue (Slack, 2002). However, it is not the question of property tax been accepted, but how responsive is the local authorities towards service provision. Since the current issue is how to increase the revenue base of Local Governments through property taxation, this has been a recurring subject to countries around the world. Kuppusamy, (2008) provision of urban services to its communities is part of the function of Local Governments which is a public agency. However, this definition is incomplete because it only emphasizes on service delivery, the legal status is not defined. Therefore, from a different point of view, in subsystems local government is a subsystem operating within these systems

The government gave mandate to the local government, which by implication represents power from state or federal government. In terms administration and finance it has limited autonomy, it can be sued by others and have power to sue property (Government of Malaysia, 1970). Also this definition lacks explicit content in terms of service delivery to the community. Similarly, independent legal existence from government is associated with local governments. It represents the amalgamation of urban and rural area, and could be either rural or urban areas which is subordinate to the state government (Phang, 1989). This definition only defines the legal status and the position of the local government but does not take cognizance of the revenue generating capacity of the local government.
as enshrined in the constitution (Local Government Act 171, 1976). Similarly, the responsibility of the Local Government in service delivery is also not mentioned in the definition. Bryon (2007) defined Local Government as an administration which has an area smaller than a state: comprises of county fire protection district, school districts, towns, cities and villages.

The provision of basic infrastructure such as water supply, street lightening, and disposal of refuse, communication halls, market stalls, roads among others is to be performed by the Local Governments being the third tier of government and also deals directly with people at the grassroots. This definition also lacks of legal status, and emphasis is only on service and infrastructural provision and fails to state the position of the local government. Hence, comprehensively, Local Government can be defined as a sub-system having an independent legal existence from the government, having the authority to generate income from rates and mandated to redistributes services and infrastructural development, subordinate to the state government and excising the power of jurisdiction in a particular area.

In order to supplement government statutory allocation it is expected that Local Governments should generate resources towards fast development (Kuye, 2002). In this context this statement is too wide because local governments have various sources of generating revenue. However, a different view which is more precise stated that, there is a need to improve such system as property tax as alternative sources of revenue in order to supplement funding from the National and State Governments. Local Government is given the power to issue a precept or to levy a rate that is a crucial need for improvement (Hadfield, 1958). In addition, it is posited that, for Malaysian Local Governments property tax is one of the main source of revenue (Dzulkanian, 2008). But the Local Governments should not over rely on the property tax as the only source of income generation. However, in Malaysia the Local Governments generates its revenue mainly from assessment taxes. Therefore it is financial declaration of accounts always of interest the general populace. It is very important for the Local Governments to rationalize the revenues generated. Since property tax is levied to provide services by the local authority (Abdul Aziz, et al, 2007).

2.1 Overview of Property Tax

Property tax came into existence for the appeasement of the poor living in the communities. It was officially introduced by the proviso of the law in Britain known as the Poor Relief Act of 1601, also called the Statute of Elizabeth. The law stipulated on taxes on every occupier of land or property. Malaysia as a British colony inherited most of the British administrative system, among which is the property tax. Property tax is charged upon the enjoyment of the facilities provided by the local governments, (Hakim, 1987). While, a conflicting view is that, property tax is a tax by the local governments on immovable properties for example factories, houses, shops, offices within the jurisdiction of a municipal council. Another contrasting view on property tax is that, it is a tax imposed on the value of a property and to be paid by the tenant of that property.

In Malaysia, the rate payable on a property is collected by the local government, it is known as assessment tax. It is charged for the governments to cover expenses for services and development projects; therefore the basis of tax assessment should be comprehensive and uniform (Bardai, 1987). There may be laid down procedure of determining the market value of some of the types of hereditament which is statutorily used (Richard M. Bird and Enick Slack, 2005). Similarly, market value is the estimated amount for which an asset will exchange as at the date of appraisal between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably prudently and without compulsion (IVSC, 1994). Contradictorily, Youngman and Malme (1994) opined that tax area-based assessment and value-based assessment are the two different assessment approach universally adopted, the latter is further divided into rental and capital value approaches.
2.1.1 Principles Guiding Property Assessment

There are established principles guiding assessment through which local authority generates its income by imposing rates on rateable properties. Bujang and Abu Zarin, (2001) supports this and stated that capabilities to increase revenue from tax determines the ability of a local authority to execute its authority and functions. Many scholars attest to the fact that property tax is a lucrative means of generating revenue for local governments; Layfield (1976) supports this by his statement, that rating generates a substantial proportion of local government revenues. The author further added that local taxation should have the following criteria: first, properties must be located within the jurisdiction of the local authority; second, local taxation must be simple and accepted by local taxpayers while any change or amendment must be clearly be explained; third, tax imposed should be paid directly by local owner; and fourth, property tax should take into account the undesirable nature of properties, meaning those features which cannot be converted or be corrected to suit taxation purpose.

However, from a different perspective, the principles guiding property assessments according to Alberta Urban Municipalities Association (2012) posited that, properties should be appraised objectively, equitably, and uniformly, since assessment of properties is the basis for the distribution of the property tax burden. Open and transparent property owners understand how property is assessed and taxed. Property assessment is predictable. Sufficient capacity and resources, provincially and locally, to administer the property assessment and taxation system property is assessed in a consistent and accurate manner.

2.1.2 Approaches in Property Tax Assessment

Various countries have different practicing approach to property tax assessment, it solely hinges on their statutory provision and the peculiarity of their country or region. For example, Richard M. Bird and Enick Slack (2005) stated three methods are commonly used to estimate market values: Comparable sales approach; Depreciated cost approach and; Income approach/ rental value (or annual value) approach.

Contrarily, the Land Registry Services Hong Kong (2006) stated five approaches to property tax assessment. They are: Direct comparison approach; Appraisal approach; Investment approach; Profits approach and, Replacement costs approach.

2.2 Property Tax in Malaysia

Property tax is levied to fund provision of public social services, construction and maintenance of infrastructures which involve roads, environmental control, waste management, sewers and drain, pollution control provision and maintenance of street lights, markets pollution control, playgrounds. Mohamed (1998) share the same view and stated that the major functions of Malaysia local authorities can be concisely named as developmental, public, environmental and social. 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.

2.2.1 Property Tax Collection System

Legislation which enforces rate in Malaysia was Local Government Act, 171 of 1976. Part XV in Local Government Act, 1976 entitle the jurisdiction of rating and valuation. Section 127,
Local Government Act, 1976 stated that local authorities must have the approval from the State Authority before imposing any rates on all rateable holdings. Section 127, Local Government Act, 1976 state that the local government may, with the approval of the State Authority, from time to time as is deemed necessary, impose either separately or as a consolidated rate, the annual rate or rates within a local authority area for the purposes of this Act or for other purposes which it is the duty of the local authority to perform under any other written law. Before the local authority can implement rates collection from all rateable holdings, a Valuation List must be prepared. Valuation List is one complete record of information on all rateable holdings of one local authority. According to Section 137 (1), Local Government Act, 1976, state that: The local authority shall cause a Valuation List of all holdings not exempted from the payment of rates to be prepared containing:

- The name of the street or locality in which such holding is situated
- The designation of the holding either by name or number sufficient to identify
- The names of the owner and occupier, if known
- The annual value or improved value of the holding
- Reminder and actions that would be taken
- Withdrawn date of bill
- Account number
- Locational address of place of payment
- Period or due date for payment
- Percentage of rates as stipulated in section 130, Act 171 of 1976

However, according to Kuye (2002) part of the process for property tax collection involve distributing demand notice to those people on the valuation list. The demand notice usually contain the following information:

- Address of the property
- Location of the property
- Rate payable
- Assessed value of property
- Where to pay
- Who to pay
- Time duration upon which the bill must be paid
- Penalty for not paying at the stipulated period

### 2.2.2 Delivery of Bills and Property Tax Assessment Payment

As stated in Section 133, 127 and 128, Local Government Act, 1976, the rates shall endure for any period not exceeding twelve months and shall be payable half-yearly in advance by the owner of the holding at the office of the local government or other prescribed place in the months of January and July and shall be assessed and levied in the manner hereinafter provided. Property taxes are payable two times a year. Payment required for:

- Claims in the first half (1 January-30 June)
- Claims for the second half (July 1 to December 31)

Similarly, on the same issue from another viewpoint, Kuye (2002) stated that there are two major assignment involved in the process of rate collection. These are:

- Sending demand notice
- Settlement of rate bills
In the fourth stage the owner of the property is expected to pay the property tax either in the 1st half year with due date as 30th June or the 2nd half of the year due date December 31st if failing which, after 15 days, then form E would be issued, followed by a warrant. Then form G if the owner still fails to pay after 7 days then the movable property would be sold in an auction if there is no contest. Rates assessment payment usually made annually but the owner of the property could pay by installments namely like payment semi-annual that is in the month of January and July. This means that payment is made according to bill delivery dates. Payment of annual installment is in the month of January and July. If the owner of a property wants to make payment in the month of January, allowable payments is given till the end of February, whereas if the payment is made within the month of July, allowable payment is given till the end of August (Section 147(1), Local Government Act, 1976 (Act 171)).

2.2.3 Issues on Property Tax Collection

In municipalities, arrears on property tax occur because of internal and external inadequacies Pawi et al. (2012).

2.2.3.1 The Internal Factors

Internal factors are borne within the organization and partially contributed to the low property tax collection and lead to the tax arrears. First, The Local Government is always having staff shortage to handle property tax collection. Issues on lack of staff in managing and administering property tax bills and following up payment is not well proportionate to the total area covered within the municipality.

Second, sometimes, there are too many names of owner in a lot of land. This situation normally occurs in a big size land lot. Sometimes, rates assessment bills do not contain all the names of owners. Therefore, for those owners, which their names do not appear on the bills would refuse to pay rates to Local Government.

Third, on some cases, especially for vacant land, which had no complete address, lead to the difficulty for Local Government on sending rates assessment bills to properties owners. Locating the owners’ current addresses would take times and this may contribute to the property tax arrears as the owner of the property fail to pay property tax within the specific time due to unable to locate them.

Fourth, methods applied during the property assessment process are cumbersome and take long time to complete. These need further urgent modification and reform in enabling taxpayers receives the property tax bill within the reasonable time frame.
Fifth, the payment process is may be convenient to taxpayer pays at the Local Government for those residing close to the municipality. But, it might be it may not be convenient to the majority of the taxpayers because of the distance they have covered to make the payment. Meantime, the process of payment is not well articulated. This might deter some taxpayers from prompt payment, which may increase the incidence of tax arrears, and this directly affects the infrastructural development and service provision by the Local Government. The quantum of provision of infrastructure and service provision lies heavily on the available resources of the Local Government. Therefore, tax non-compliance seriously depletes the income generation of the Local Government.

2.2.3.2 External Factors

These are factors, which are borne outside the Local Government that contributed to property tax arrears. First, the tax is perceived to be unfair, by the taxpayers because the quality of services and facilities available do not commensurate with the amount of property tax payable. The taxpayer’s are not satisfied with the services provided by Local Government.

Second, there are no up to-date records of all land transactions within the municipal council. Hence, there are cases of transfer of ownership but is not reported or documented, therefore the Local Government is not aware of such transaction. Some properties are sold but the valuation department sends out the rates assessment bills to the old property not the new owner. The new property’s owner refuses to pay rates by reason the bills do not state his or her name. Taxpayers are not adequately educated or sensitized about the significance of reporting their land or property transactions to the municipal council for appropriate record keeping. This have advantages because once the proper authority have it in the owner’s record, then nobody can claim or contest for the ownership of that property.

Third, for those houses that are rented out to other parties, most tenants do not care about rates assessment bills they receive, they do not pass the bills on time to house owners. As such the owners receive the rates assessment bills at a late hour. So, they do not pay the rates on time. This host of issues infringes on the resource mobilization capacity of the local government (Sachs, 2005).

Fourth, property tax arrears is also another issue, there is adequate provision of the law to checkmate defaulters in payments of property tax to curb the increasing issue of tax avoidance. According to Section 147 (2) Local Government Act 1976, if the owner of the property fails to pay the rates assessment payment to Local Government by the end of February or by the end of August in each year, it can be defined as an arrear and the payment can be recovered as stated in Section 148 Local Government Act 1976. So, rates arrear is a property tax that is not paid on time. Section 147(2) Local Government Act 1976 state that “If any such sum or any part thereof remains due and unpaid by the end of February or by the end of August in each year, as the case may be, it shall be deemed to be an arrear and may be recovered as provided in section 148 (1).

Attitudes and Perceptions of Taxpayers

Fischer’s tax compliance model provides a framework for understanding the influence of those socio-economic and psychological components on taxpayers’ compliance decision Chan, et al. (2000) Fischer’s model is a single model, which combined social, economic, social and psychological factors and a viable conceptual framework for understanding tax compliance behavior. However, Alm (1999) contended that no single model can account for the enormous factors influencing tax compliance decision and stated that other factors may well be relevant in explaining tax compliance behavior. The Fischer model suggests two major considerations for altering taxpayers’ attitudes and perceptions to tax compliance. These are the fairness of the tax system and peer influence. 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 non-compliance. Porcano (1984) finds that taxpayers’ needs and ability to pay are the two 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.

Conclusively, in country like Malaysia the taxpayer’s perceptions cut across differences in income, different levels of education and different ethnic groups. Regarding tax payment, this may cause variation in compliance behavior in different parts of the country. Because it is observed that, Culture is considered to be a powerful environmental factor that affects the taxpayer’s compliance (Chan and Leung, 2009). These factors are categorized by Fischer and associates (Fischer et al., 1992) into 4 groups in his expanded model.

![Fischer’s Model of Tax Compliance Behavior](image)

Figure 2 Fischer’s Model of Tax Compliance Behavior, (Fischer et al. 1992).

Jackson and Milliron (1986) carried out a comprehensive review of the tax compliance literature and identified 14 key factors on tax compliance. These factors are categorized by Fischer and associates (Fischer et al., 1992) into 4 groups in his expanded model (Fischer Model):

- **Demographic** (age, gender and education).
- **Non-compliance opportunity** (income level, income source and occupation).
- **Attitudes and perceptions** (fairness of the tax system and peer influence).
- **Tax system/structure** (complexity of the tax system, probability of detection and penalties and tax rates).

Thus, Fisher model of tax compliance incorporates economic, sociological and psychological factors into a comprehensive one. These factors affects the taxpayers in one way or the other, the essence of the model is to understand the taxpayers’ way of thinking and circumstances surrounding their view to create an enabling environment for tax compliance.

**Taxpayer’s Expectations on the Property Tax Collection Generation**

Youngman and Malme (2004) noted that the difference between physical and legal persons, existing in most post-soviet legal systems, is not essentially for property tax law, but it also not an obstacle to taxation on properties so long the taxpayers’ rateable holdings can be identified within the taxable jurisdiction. It can be deduced that the taxpayers are very observant. Where services due for them from the local authority are not guaranteed it creates a negative reaction in terms of compliance. Fjelstad, (2001) has summarized the reasons for resistance from taxpayers as:

- Taxes are widely perceived to be unfair. Taxpayers see few tangible benefits in return for the taxes they pay.
- Virtually no development activities are undertaken through councils’ financial sponsorship, and even the existing capacities are not producing the expected services due to lack of operation and maintenance funds.
The deterioration and in some cases non-existence of public services heightens taxpayers perceptions of exploitation from an unequal contract with the government. This promotes tax resistance. Thus, tax resistance may be considered as an attempt by the taxpayers to adjust their terms of trade with the government.

Therefore, in circumstances where taxes are perceived to be unfair and people receive few tangible benefits in return for taxes paid, it may be expected that only coercive method of tax enforcement will generate tax revenues. The reciprocity or contractual relationship between taxpayers and the local government seems to be absent. Moreover, harsh tax enforcement combined with poor service delivery contributes to undermining the legitimacy of the local government and increase tax resistance.

Moreover, the tax is perceived to be unfair by the taxpayers because as far as they are concerned the quality of services and facilities available do not measure up. The taxpayer’s are not satisfied with the services provided by the Local Government. They believe that the service provided by Local Government was not satisfactory enough compared to the amount of rates paid. The circumstance creates an unenthusiastic attitude towards payment. Hence, it became easy to default on the tax payment. Some of the taxpayers do not really know what the money is all about; therefore they are not obliged to pay the property tax, this serves as an excuse to the ratepayers. Hence, this issue leads to the existence of property tax arrears problems.

3.1 Conclusion

There is no machinery put in place for evaluation of performance on property tax collection at Local Government in Malaysia. This is extremely important because it always serve as check to measure the performance standard, it assist in revealing the tax gap, which is the amount of tax liability faced by taxpayers that is not paid on time (IRS, 2012). However, the evaluation between the expected property tax revenue and the realizable property tax revenue, serve as a pointer to measure the performance against the set standard and whether or not there is conformity in the system of tax adopted compared to the one practiced so as to correct any deviation from standard. This could also indicate whether the problem is internal or external. Property tax collection is facing challenges in view of the existing issues surrounding it. Therefore, it is imperative to find a sustainable solution to the persisting problem. This paper creates an opportunity for further research in the domain of property tax collection reform, which directly affects the revenue generation of sustainable Local Governments in Malaysia.

References


