AN OVERVIEW OF PROPERTY TAX COLLECTION AS A TOOL FOR A SUSTAINABLE LOCAL GOVERNMENT REFORM 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. However, the current issue is how to increase the revenue base of Local Governments through property taxation. This is because tax collection revenue generated is seriously declining according to the Economic Report of the Ministry of Finance, said that performance of the revenue collection in Local Governments throughout the country showed an alarming decline. Similarly, recent study has shown that the low income generation from property tax has resulted in the reduction in expenditure due to persistent increase in budgets allocations. Most significantly, recent pilot survey reveals that there has been a persistent problem of declining property tax collection generation in Pasir Gudang Municipal Council Malaysia. Therefore, the aim of this paper is to study the problems associated with low property tax revenue generation in Malaysia. The study intends to find out the reason 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 study 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 sustainable property tax collection reform that the problem of low revenue generation can be resolved.

Keywords; Property Assessment, Local Government, Property Tax, Revenue Generation, Tax Reform.

1. Introduction

Property tax is generally practice by countries around the world, sharing this view is Dzulkanian, 2011) he stated that, almost all governments around the world rely to some extent on property taxation. Similarly, property taxes are the main sources of revenue for municipalities in Canada, United States and Australia according to (Enick Slack, 2002). However, it is not the question of property tax been accepted, but how responsive is the municipal 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. According to Kuppusamy, (2008) the Local Governments is a public agency that provides urban services to its communities. 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, local government is a subsystem operating within or among other subsystems.

Higher government gave its one body handled on local issues which represents power whether from federal government or state government, which has limited autonomy in terms of financial and administration, have power to sue and be sued by others and have legal property (Government of Malaysia, 1970). Also this definition lacks explicit content in terms of service delivery to the community. Similarly, local government denotes the government of urban area, rural area or combination of urban and rural area, subordinate to the state government, but having an independent legal existence from the government (Phang Siew Nooi, 1989). This definition only define 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 any government that covers an area smaller than a state: this includes cities, village’s town’s school district, county fire protection district and the like.

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 lack legal status, and emphasis is only on service and infrastructural provision, he did not 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.

Local Governments are expected to harness resources towards rapid development to supplement government statutory allocation (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 for alternative sources of revenue to complement grant from the Federal and State Governments, the power to levy a rate or issue a precept to that effect is given to the Local Government that is why it is imperative for Local Governments to improve such system as property tax (Hadfield, 1958). In addition, it is posited that, property tax is one of the main resource for Malaysian Government as well (Dzulkanian, 2011). But the Local Governments should not over rely on the property tax as the only source of income generation. However, The Local Governments in Malaysia derives its revenue mainly from assessment taxes. Therefore it is financial accounts are always of interest to the public. It is very important for the Local Governments to justify the revenues generated. Since property rating is a form of tax levied on property in lieu of services provided by the local authority (Abdul aziz, et al, 2007).
2. 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 a process of determining a value charged for maintenance of infrastructures, it is a tax on people who enjoy the facilities provided by 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. This definition does not apply in Malaysia, applies to UK and Nigeria. However, is a tax imposed on the value of a property and to be paid by the owner of that property.

In Malaysia assessment tax can be referred to as a rate, payable on a property which is collected by local government. The basis of tax assessment should be uniform and comprehensive for the governments to cover expenses for services and development (Bardai, 1987). There may be a statutory provision stating the laid down method of determining the market value of some of the types of hereditament is to be adopted, (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). However, a Contradictory view from Youngman and Malme (1994) he opined that; two distinct assessment methods is universally used which are property tax area-based assessment and value-based assessment, with the latter being divided into capital and rental value approaches.

However, all the definition did not explore the legal aspect of ownership in their definition. The mere fact that a person wants to sell a property does not make the property his own, because fraudsters are mostly associated with deals on property. From my point of view, 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 (owner) or his representative in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably prudently and without compulsion.

2.1 Property Tax Objectives

The objectives property tax are the pillars which supports or assist the local governments stated aim or goal. According to Mangaung municipal council, (2009) the objectives are: ensure that all ratepayers within a specific category are treated equally and reasonably.
Also to determine the rate which is based on the value of all rateable property taking into account exemptions, reductions and rebates that the municipality may approve from time to time. More so to make certain that rates are levied in accordance with the market value of the property. In addition, to optimally safeguard the income base of the municipality by only approving exemptions, reductions and rebates that is reasonable and affordable. The stated objectives are the blue prints to the targets set by the local governments, for the development of the local government. In addition, the afore mentioned objectives serve as a guide for Local Government property tax collection, to foster equity, fairness and transparency in the conduct of property assessment, property tax levied, enforcement against non-compliance, exemptions and relief and redistribution of services and infrastructural development.

Another different view of the objectives of property tax is according to South African Government Gazette, 2004) are; determination of criteria to be used, provision of the criteria to be used for property tax, equity, consideration of rates levied, exemptions and rebates consideration of effect of rates on poor and measures to them, consideration of effect of tax on public benefit organization, consideration of service infrastructures, identifies property not rated in the municipal. There exist similarities in the objectives set by the municipal councils, but it fundamentally depends on the stated goals of an organization.

2.2 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; the ability of a local authority to execute its authority and function depend upon their capabilities to increase revenue from tax. 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 is a form of tax levied on property and generates a significant proportion of local government revenues. The author further added that local taxation should have the following criteria.

a) Must be lies within an area of a local authority and local authority should capable to change or diversify rate of tax.

b) Local taxation must be obvious and accepted by local taxpayers. Any amendment and change must be explained clearly by local governments.

c) Local taxation imposed can be paid directly by local buyer.

d) Local taxation does not necessarily contain all features needed in the taxation system, but should take into consideration the unwanted nature, which those features which cannot be corrected or being converted in taxation system.

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.

2.3 Approaches in Property Tax Assessment

Richard M. Bird and Enick Slack (2005) stated that the three methods are commonly used to estimate market values are:

- The comparable sales approach
- The depreciated cost approach.
- Under the income approach/rental value (or annual value) approach.

However, contrary to only three approaches Land Registry Services Hong Kong (2006) stated that there are five approaches to property tax assessment and they are;

- Direct comparison approach.
- Appraisal approach.
- Investment approach.
- The profits approach.
- The replacement costs approach.

However, various countries have different practicing approaches to property tax assessment, it solely hinges on their constitutional provision and the peculiarity of the country or region.

3. Property Tax in Malaysia

Property tax is imposed to finance construction and maintenance of public facilities such as public toilets, bus stops, children's playgrounds, parks, and other markets. Provision of social services, businesses, factories, parks and public places, construction and maintenance of infrastructure such as roads, sewers and drain, provision and maintenance of street lights. Mohamed (1998) share the same view, he stated 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.

3.1 Property Tax Collection System in Malaysia

Legislation which enforces rate in Malaysia was Local Government Act, 121 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:_

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

However, according to Kuye (2002) he stated that sending demand notice to those whose name appear on the valuation list is part of the process for property tax collection. The demand notice usually contain the following information:

i) Address of the property
ii) Location of the property
iii) Rate payable
iv) Assessed value of property
v) Where to pay
vi) Who to pay
vii) Time duration upon which the bill must be paid
viii) Penalty for not paying at the stipulated period

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

This is stated in Section 133, Local Government Act, 1976 as: “The rates referred to in sections 127 and 128 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 two times a year. Payment required for:

i) Claims in the first half (1 January-30 June).
ii) 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 assignments involved in the process of rate collection. These are:

a) Sending demand notice
b) Settlement of rate bills

![Diagram of Property Tax Collection Process](image)

In the third 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 he did not pay after 15 days, then form E would be issued, followed by 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 instalments namely like payment semi-annual that is in the month of January and July. This means that payment made according to bill delivery date like payment annual installment that is in the month of January and July. If the owner of a property wants to make payment in the month of January, he will be allowed make payments till the end of February whereas if payment made within the month of July, he gives opportunity to pay till the end of August, as stated in Section 147(1), Local Government Act, 1976 (Act 171).

4. Problems Encountered by the Local Government in Property Tax Collection
According to Abdullah (1993), the factors that influence the success of rates arrears are identified. These are the factors that make tax collection unsuccessful, and they are categorized into two;  
i) Internal factors  
ii) External factors  

4.1 The Internal Factors  

These are those problems that are borne within the organization. They are;  
a) Lack of staff to handle rates collection system. The number of staff at each treasury department of a local authority was not enough compared to the total area of the territory expected to be covered.  
b) 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. So, for those owners which their names do not appear on the bills, they refuse to pay rates to Local Government.  
c) Vacant land which had no complete address, this situation is difficult for Local Government but not impossible to send rates assessment bills to property’s owner.  
d) The methods applied during the assessment is cumbersome and slow which needs modification or reform.

4.2 External Factors  

These are factors which are borne outside the Local Government they are;  
a) 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 payers in a local area are not satisfied with the services which are provided by Local Government.  
b) There are cases of transfer of ownership but is not reported/documentured therefore the local authority is not aware of such transaction. Some properties are sold but the valuation department sends out the rates assessment bills to the old property owner not the new owner. The new property’s owner refuses to pay rates by reason the bills do not state his or her name.  
c) 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 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 Jeffrey Sachs (2005).  
d) Property tax arrears is also another issue, there is adequate provision of the law to checkmate defaulters in payments of property tax so as 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).

4.3 Attitudes and Perceptions of Taxpayers in Malaysia

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) support this statement, they stated that Fischer’s model is a single model, which integrated economic, social and psychological factors and a viable conceptual framework for understanding tax compliance behavior (Chan, Troutman & O’Bryan, (2000). However, Alm (1999) contended that no single model can account for the enormous factors influencing tax compliance decision and submitted that other factors may well be relevant in explaining tax compliance behavior. The Fischer model suggests 2 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 noncompliance. 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.

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

(i) Demographic (age, gender and education)
(ii) Noncompliance opportunity (income level, income source and occupation),
(iii) Attitudes and perceptions (fairness of the tax system and peer influence)
(iv) 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 him or her with a view to create an enabling environment for tax compliance.

4.4 Taxpayer’s expectations on the Property Tax Collection Generation

Youngman and Malme (2004) The differentiation between legal and physical persons, found in most post-soviet legal systems, is not necessary for property tax law, but neither is it an impediment to property taxation as long as a taxpayer can be identified for each taxable parcel of property within the taxing jurisdiction. It can be deduced that the taxpayer is very observant. Where services due for him/her from the local authority is not guaranteed it creates a negative reaction in terms of compliance. Fjelstad, (2001) has summarized the reasons for resistance from tax payers as;

i) Taxes are widely perceived to be unfair. Taxpayers see few tangible benefits in return for the taxes they pay.

ii) 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.

iii) 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, we may expect 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.

5. Conclusion

There is no machinery put in place for evaluation of performance on property tax collection at Pasir Gudang municipal council. 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.

The process payment is that a Taxpayer pays at the Municipal Council may be convenient for those residing close to the Municipal Council. But it might be it may not be convenient to the majority of the tax payers because of the distance they have to cover to make the payment. The process of payment is not well articulated. This might deter some taxpayers from prompt payment which may increase the incidence of tax arrears, which is presently experienced at Pasir Gudang Municipal Council and this directly affects the infrastructural development and service provision by the Municipal Council. 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 Municipal Council.

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 authority 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 it is advantages because once the proper authority have it in the owner’s record, then no nobody can claim or contest for the ownership of that property.
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 wasn’t satisfactory enough compared to the amount of rates paid. The circumstance creates an un-enthusiastic attitude towards payment. Hence it became easy to default on the tax payment. Some of the taxpayers don’t 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 rate payers. Hence, this issue leads to the existence of property tax arrears problems.

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. The study creates an opportunity for further research in the domain of property tax collection generation, which directly affects the revenue generation of Local Governments in Malaysia.

REFERENCE


