

# URBAN GOVERNMENT FINANCE: Emerging Trends in

## Property Tax Policy in Nigeria

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### 1.0 GENERAL BACKGROUND

Taxes on land and buildings can serve important economic, political and legal objectives in developing new fiscal policies and new approaches to property rights in a democratic society and developing economics.

Nigeria offers important perspective from which to view the development of property taxation in the context of the economic, fiscal, and political changes that have occurred since independence. Nigeria has continued in decades to grow economically, with a thriving private sector and steadily improved quality of life despite all threats to security of the nation

As Nigeria continues to sustain its economic growth and invest wisely, it will be able to finance better services and raise its standard of living. Land is a major resources, and real estate investment and development play important roles in the reallocation of assets to sustain and nurture growth.

Transforming Nigeria economy through effective land management and property taxation is imperative in the sense that land is life and a platform for economic activities. The existence of bundle of interests in land market is a vital basis of all wealth. Therefore, raising revenue in form of taxation for sustainable infrastructural provisions and urban services would definitely impact positively on the economy of Nigeria.

For urban infrastructure and services to be sustained, land should be professionally administered and managed whereby reasonable land charges and taxes must be levied and paid to create and meet urban needs in Nigeria and sustain development. The wealth in Nigeria from land is more than enough to develop and sustain states, local governments and the Federal Capital Territory (F.C.T.) provided it is well managed and administered by Nigerian professionals.

Efficient reallocation of land assets and users will require financial incentives in the form of market-based rents, and improved methods of transfer-registration and protection of property rights, easier access to credit, and reflection of the real value of real estate in taxation and infrastructure fees.

As market transactions in real estate increase, financial institutions grow stronger and public policy formation continues to mature. Nigeria is well positioned to develop urban strategy that is economically efficient and equitable for various social and income groups.

Nigerian economic and physical transformation agenda is evidenced in many states such as Lagos, Oyo, Ogun, Ondo, Rivers and Katsina states in terms of human capital development, urban renewal programmes, infrastructures regeneration, improved security arrangement and good governance. The on-going urban renewal projects in the South-Western States of Nigeria offer the opportunity to restore integrity and character to a depressed neighbourhood in the major urban centres.

A number of considerations led to the designation of property taxes as local revenue sources. It is an immovable tax base which offers the possibility of independent local revenue even at the time of economic crisis. Property tax is an appealing local revenue generating option for developing countries given the primary store of accumulated wealth tied up in real estate. In addition, it is hard to avoid legally due to its high visibility and immobility. Despite its faults, however, the tax continued to provide revenue for even the most elaborate systems of local government in the world. Therefore, improved property tax revenues would continue to contribute critical resources necessary to enable local authorities to provide the level and quality of services required to sustain and promote further economic and social development.

The states and federal governments and even local governments must engage relevant professionals in the administration and management of lands and land-based taxes or whatever change in the nomenclature the states may give the property tax law. Land based-taxes or whatever nomenclature given to it are better handled by registered Estate Surveyors and Valuers as contained in the provision of Decree 24 of 1975 now cap III, NFL, 1990 that established the Nigerian Institution of Estate Surveyors and Valuers (NIESV).

The objective of this paper is to get a better understanding of the development of a successful system of property taxation in Nigeria in order to broaden our knowledge of the available alternatives and their relationship to specific political, legal and economic settings.

## 2.0 URBAN GOVERNMENT FINANCES AND RESOURCES MOBILIZATION

Nigeria is a federation with power and responsibilities shared between the Federal Government and thirty (36) constituent State Government. Local Governments are constitutionally recognized but are subject to the creation, control and regulation of the State Governments. As in similar federal structures, the power and ability of state governments to manage their public expenditure depend largely on the fiscal federalism arrangements in place.

Revenue sharing is an arrangement in which the revenue from a given tax base accrues to both the central and sub-national governments. It ensures sub-national governments have access to a specified source of revenues to carry out their functions while attempting to provide greater harmony in levying taxes. In other words, revenue sharing is an attempt to enhance net welfare gains by ensuring greater fiscal autonomy on the one hand and by minimizing the welfare loss from tax disharmony on the other.

**Table 1.1: Revenue Assignments For Federal, State and Local Governments in Nigeria**

S/No.	Federal Taxes	State Taxes	Local Taxes
1.	Company Income Tax (CIT)	Personal Income Tax	Poll Tax
2.	Petroleum Profit Tax	Pay As You Earn	Tenement Rate
3.	Value Added Tax	Withholding Tax (Individuals)	Licenses, Fines And Fees
4.	Education Tax	Capital Game Tax (Individual)	Name of Street Fees
5.	Personal Income tax in respect of: <ul style="list-style-type: none"> <li>• The Armed Forces</li> <li>• FCT residents Abuja</li> <li>• External Affairs Personnel</li> <li>• Non-Residential</li> </ul>	<ul style="list-style-type: none"> <li>• Markets where State Finances are Involved</li> <li>• Stamp Duties</li> <li>• Pools Betting and Lotteries</li> <li>• Road Taxes</li> <li>• Business Premises Registration</li> </ul>	<ul style="list-style-type: none"> <li>• Market Fees</li> <li>• Motor Park Fees</li> <li>• Signboard and Advert permit Fees</li> </ul>
6.	<ul style="list-style-type: none"> <li>• Import Duties</li> <li>• Exercise Duties</li> <li>• Other Oil Revenue</li> <li>• Crude Oil Revenue</li> <li>• Crude oil State</li> <li>• Mining Parts &amp; Royalties</li> <li>• Upstream Gas Sales</li> <li>• NLNG Gas Sales</li> <li>• Domestic Crude Sales</li> </ul>	<ul style="list-style-type: none"> <li>• Development Levy</li> <li>• Rent on Govt. Ppt.</li> <li>• Naming Streets at State Capitals</li> <li>• Fees on C of O</li> <li>• Other Revenue e.g. License, Fines &amp; Fees</li> <li>• Reimbursement</li> </ul>	<ul style="list-style-type: none"> <li>• Radio License</li> <li>• Rent on Govt. property</li> <li>• Earning on LG. Property</li> <li>• Interest and Dividends on Investment</li> <li>• Miscellaneous</li> </ul>

**Sources:** *The Joint Tax Board.*

Revenues and tax powers from the table are still highly centralized with the Federal Government shepherding the most important and buoyant taxes and other revenue sources, albeit in trust for the component governments of the Federation. These revenues are aggregated in the Federation and other accounts and shared periodically among the constituent governments.

Nigeria's current revenue-sharing formula is summarized in diagram 1. The vertical formula gives Federal Government **48.5%**, States **24%**, Local Governments **20%** and Special Funds **7.5%**. The horizontally formula is shared as follows: Equity **40%** Population **30%**; Social Development Factor **10%**, Land Mass and Terrain **10%** and Internally Generated Revenue **10%**. Only federally-collected revenues are subjected to this revenue-sharing arrangement. The states and Local Government keep whatever internal revenues they are able to raise themselves, but share from federally-collected revenues. The reason for this is that virtually all the major taxes are federal taxes, and the revenues there from Vat distribution is Federal Government 15%, State Governments 50% and Local Government Areas, 35% annually constitute about 90 percent of the total revenues of all the three tiers of government in Nigeria.

## **2.1 Tax and Revenue Powers of Local Governments**

Local government finance generally, includes almost all conceivable areas such as revenue, expenditure, budgeting and financial control. Not only are the financial needs of local governments increasing, but the degree of financial autonomy in raising and managing these revenues also has to increase (Paugam, 1999). In order to raise sufficient revenue to provide infrastructure and services, municipalities have recourse to local and external sources of revenue (Roy W. Bahl and Johannes F. Linn, 1998). These are:

- (i) **Licenses, Fees, Penalties etc**
- (ii) **User charges, Rents, Town Planning levies, Ground-rents:** - These are primarily aimed at making those who use services pay for them.
- (iii) **Local Rates, Poll Taxes, Betterment Levies and Valorization Tax:** Are normally the ones typically under the control of municipalities. Valorization tax is a form of special assessment to recover infrastructure costs in Latin America countries.
- (iv) **Block Transfer from National Government:** They are typically a large and important source of revenue for municipal governments in developing countries.

Local governments are also generally assigned expenditure responsibilities for a wide range of services which include roads and transport, water and sewerage service, solid waste collection

and disposal, recreation and culture, land use planning, social services, public health and social housing.

At the generic level not all local governments are equal. There are large and small municipalities, heavily urbanized and rural municipalities, rich and poor areas (Bird, 1990). These inequalities in relation to access to local public resources can be significant. Striking differences between big cities and rural local governments may be found in most states in Nigeria, reflecting both the fact that big cities have higher per capital tax base and that they tend to carry out a wider range of functions than the rural or less urbanized local governments.

However, the degree to which a city's government is also able to meet its rapidly rising expenditure requirements depends only in part on its revenue capacity as determined mainly by the economic base of the city and by the restraints imposed by higher-level governments. It also depends on the revenue effort, that is, the extent to which the local government is using its revenue capacity.

## **2.2 Concept of Rent is Different from Taxation and Rating Principles**

It is unconventional to lump rents, ground rents with Land Use Charge or any form of Real Property-based Taxes.

The definition of Land Use Charge as **“all property and land-based rates and charges payable in Lagos and Oyo State”** is an aberration as far as principles and practice of property taxation is concerned around the world.

“Land-based rates referred to are ground rents, survey fees, development charges and others payable on land allocated by federal, State and Local Governments, including their Agencies like Property Development Corporation, Nigerian Railway Corporation other public Development Agencies and Private Developers and Individuals.

Rate is defined as a tax for local purpose imposed by authorities the basis of which is the annual or capital value of land and building (or improvement on land) at the current market rates.

Whereas, tax generally is a compulsory levy imposed by the government on its citizens to meet the expenditures of the government in the provision of amenities and general needs of its citizens

(a) **RENT** is defined as a stipulated sum of money paid by a tenant annually, quarterly, monthly, weekly or daily for the temporary use and possession of lands, moors, houses, rooms, etc.

**Or**

**RENT** may also be technically defined as the income which accrues from the ownership of land, or an interest in land or of other free gifts of nature.

(b) **Value of Land**

The Value of Land is determined by the **rent** which it yields, it therefore follows that the greater the rent, the greater is the value both to the owner of the property and to the general public. **Value of Land** is the capitalized value of its rental. Since the value of land depends essentially upon its rental and any future change will have a corresponding reflection in the value of land.

(c) **Property Values**

Tax assessors determine **property values** in a variety of ways, but are generally required to base such determination on **fair market value**. Common estimation techniques include: **Comparable sales, depreciated cost, and an income approach**.

(d) **Ground Rent**

**Ground rent is the rent paid for the use of the bare land usually with a view to enable construction of building or structure by the lessee as an avenue of investment.** When ground rents are realized by granting of lease of vacant land, they are normally a relatively small proportion of the full rental value thereof. The person owning the leasehold (i.e. lessor) is entitled to the reversion of the property if the ground rent is not paid.

If the rent that is received by the lessee for land and buildings is the **full annual value** of the property, it is the **RACK RENT**. It is very obvious that **secured ground rents** are one of the most attractive forms of investments.

**TAX** is a compulsory payment imposed by the government on its citizens to meet the expenditures of the government in the provision of amenities and general needs of its citizens. When citizens pay tax, they expect some benefits in return. Citizens therefore have a legitimate ground to demand fro accountability in the utilization of money collected from them in the form of tax by the government.

**(e) Property Tax or Tenement Rate** means a tax for local purpose imposed by the local authorities the basis of which is either the annual or capital value of lands and building or land alone and could be building alone. The amount of tax is determined annually based on market value or annual value of each property on a particular date. The amount of tax per annum is computed as **determined market value** times **an assessment ratio** times **tax rates**. **Amount of tax = Market Value x Assessment Ratio x Tax rate**

Unlike tax, ground rent payment has its own terms and conditions enshrined in the registered lease document. Lease is governed by various laws of the granting authorities and is quite different from nominal ground rent payable under the Statutory Right of Occupancy governed by the Land Use Act of 1978. **A State Governor is not the owner of all lands in the state but is holding the lands in trust for the people of the state.**

### **2.3 Revenues Potential of User-Related Charges For Urban Services**

Urban governments in developing countries rely on large variety to the provision or use of urban public services. These charges include public utility tariffs, special assessments to recoup the costs of infrastructure investments, fees for education and health services, and, more generally, all the types of charges which are levied on urban residents in the basis of some benefit received or cost imposed on account of service provision and use.

Users charges have contributed significantly to the level and growth of revenues of urban government in a fair and publicly acceptable manner, increase the efficiency of allocation of existing service capacity, and help guide investment decision.

There can be little doubt about the usefulness and desirability of developing broadly based charging systems for urban public services. As experience has shown, service charges or cost recovery can generate substantial amounts of revenue for urban local governments. Because service charges are likely linked to the provision and extension of much-needed services, they are an important element in urban investment policy.

The services provided by local governments subject to user fees include:

- a) Charges for the use of public toilets, street light and parks and gardens;
- b) Charges for the collection and disposal of solid waste in the market s and communities;
- c) Revenue from Mass Transit;
- d) Hiring of heavy equipment

- e) Water supply through borehole and water rates paid to a public corporation

Service charges can also contribute to equitable urban growth. Recouping the costs of public services from beneficiaries is a fair way to finance a service, and windfall gains may be minimized. Under general revenue financing, these windfall gains are often appropriated by high-income groups in the form of increased property values or increased yields from investments that benefit these groups most directly. Therefore, user-charges also serve to increase the vertical equity of the urban fiscal system.

User charges are not only a tool for ensuring efficient use and equitable financing of public services; they also serve as an investment guide, because consumers' willingness to pay for services in many instances is the only way in which the benefits of a service can be ascertained and compared with the cost of providing the service.

This will force decision makers to consider beforehand the ability and willingness of beneficiaries to pay and to design standards of service accordingly. Extensive subsidization of services in the past has often contributed to the expectation of unrealistically high standards of urban services.

Fiscal decentralization requires that sub-national governments be given responsibility for determining the level and quality of services to be provided and for raising a substantial portion of the funds to finance these services (Bell and Adams 1999; Oates 1972). Local governments in Nigeria have not yet achieved control over expenditures or revenues, and assignment of land and property tax revenues to them is a significant step in this direction.

By comparison of all sources of local revenues the property tax offers special advantages as an independent local revenue source. Many local government services funded by the property tax confer benefits on real property and increase its value, a particularly important consideration where infrastructure needs are pressing.

#### **2.4 Expenditure Responsibilities of Federating Units**

Investments by local governments in social and physical infrastructure have, however belatedly, come to be recognized as critical. The maintenance of public capital assets in urban areas is now largely the responsibility of local authorities. This is because, central government budgets have often been strained in recent years, which have made it politically more attractive to devolve responsibility for public finance to lower level of governments.

There are wide variations in the distribution of expenditures by service categories. This is to be expected because of the wide variations in urban government responsibilities, the relative severity of existing backlogs in public services, and differing policy objectives

The exact role of local government in Nigeria, according to the World Bank report on Nigeria Status Finance Study, (2002) is not yet defined. No precise authority to make laws or raise revenue is conferred on local governments under the Nigeria Constitution which include: sewage and refuse disposal; maintenance of public conveniences; construction and maintenance of roads and streets; street lighting, drains and public highways, parks, gardens etc. and such other public facilities as may be prescribed from time to time by the State House of Assembly. They are also charged with the responsibility to maintain cemeteries, burial grounds and home for the destitute or infirm.

**Table 1.2: Allocation of Responsibilities by Government Level in Nigeria**

<b>Exclusively Fed. Government</b>	<b>Concurrent Federal and State</b>	<b>Concurrent State and Local Govt.</b>	<b>Local Government</b>
<ul style="list-style-type: none"> <li>• Defence</li> <li>• External Affairs</li> <li>• Law and Order</li> <li>• Post and Commns.</li> <li>• Inter State Transportation</li> <li>• Aviation, Sea and Rail Transport</li> <li>• Currency</li> <li>• Oil and Gas</li> </ul>	<ul style="list-style-type: none"> <li>• Tertiary Ed.</li> <li>• Justice</li> <li>• Electric Power</li> <li>• Banking and Finance</li> <li>• Agricultural and Industry</li> </ul>	<ul style="list-style-type: none"> <li>• Secondary Ed.</li> <li>• Health-Care delivery</li> <li>• Water Supply</li> <li>• State Roads</li> <li>• Fire service</li> <li>• Land Use</li> <li>• Health Care</li> <li>• Primary Education</li> </ul>	<ul style="list-style-type: none"> <li>• Markets</li> <li>• Cemeteries</li> <li>• Waste &amp; Sewage Disposal</li> <li>• Local Streets Construction and Maintenance</li> <li>• Motor-Parks and Open Space</li> <li>• Establishment of Destitute Home/Infirm</li> <li>• Slaughter Houses</li> <li>• Public Conveniences</li> </ul>

*Sources: Nigeria Status Finance Study Report, June 2002 by the World Bank AFTP3.*

Although a 1998 law sets out taxing powers for local governments, state governments have sufficient powers under the constitution to override any local law. An important spending

assignment to local governments is the funding of primary school education including the payment of primary school teachers. The heavy burden led the Federal Government to deduct payment of primary school teacher salaries at source leaving many urban Local Government with nothing to meet other expenditure, giving rise to the phenomenon known as “**zero-allocation**”.

The practice of deducting the salaries primary school teacher at source was giving constitutional backing in the 1999 constitution via section 6 which provided that:

“Each State shall maintain a special account to be called “**State Joint Local Government Account**” into which shall be paid all allocations to the local government councils of the state from the Federation Account and from the Government of the State”

The primary school teachers salary is the first charge on the account payable through the State Universal Basic Education Board.

## **2.5 Factors Responsible for Capital Expenditure Growth**

Whether local governments under-produce or over produce, it is clear that they face financing problems. The more normative definition of the problem is the existence of a **fiscal gap**, that is, a gap between perceived service needs and financial resources. It is important to distinguish this from the budget deficit and understand how each is pressured by urbanization.

A useful starting point may be to cost the problems in terms of a set of identities defining the expenditure requirement and revenue constraints of urban authorities. However, “**budget deficit**” reflects the actual shortfall in recurrent revenues from estimated amount.

There is empirical evidence that local government expenditures in developing countries are driven by increases in the demands for public sources. Nigeria situation is not an exception, the following factors are responsible for budget growth of local governments:

- (i) Growth in Expenditure needs as a result of growth in population and urbanization.
- (ii) Demand for improved public services as a result of growth in the economy and improved living standard of the people
- (iii) High cost of providing quality of public service and infrastructure due to inflation and increasing wages
- (iv) Extra-budgeting expenditure on projects in posed by Federal and State governments and Local Government Councils

- (v) Presidential system of government at the local government level which has increased the cost of local governance. Each Council now has Executive Chairman, Vice Chairman, Supervisory Councilors, Special Assistants and legislative arm with 8-14 Councilors.
- (vi) Funding of primary Education and payment of school teachers
- (vii) Five (5%) of the Statutory Allocation accruable to Local Government Council is used for the maintenance of Local Government Traditional Council

In summary, there is inadequate balance between current revenue and expenditure assignment as a result of mismatch between revenue authority and expenditure assignments. This is indeed a challenge to future fiscal arrangement in Nigeria among the constituent states.

The primary explanation for non commensurate increase in revenues of local authorities with increase in public demand for services is that urban governments are often restricted in their revenue-raising authority to income-inelastic sources such as property taxes, specific fines and fees and transfers from higher-level governments (Bahl and Linn, 1998). This “**fiscal gap**” can be addressed, in principle, in four ways:

- (i) a reduction in responsibilities that require local government expenditure;
- (ii) an increase in the local authority to raise revenue;
- (iii) an increase in the amount of revenues transferred from higher-level governments, and/or
- (iv) an increase in the local effort to raise revenue in the face of unchanged revenue raising authority.

The first option, a reduction of local expenditure responsibility is frequently chosen for reason of political conveniences. Such policies are subjected to fiscal constraints imposed by the central government. Moreover, when the central or state government assumes responsibility for providing urban services, it has only limited accountability to the actual or potential beneficiaries of services and there is less likelihood that the costs of the services will be covered through user charges.

The next table shows the Local Government Fiscal performance between 2006 and 2010 as recorded by CBN.

**Table 1.3: Local Governments Finance in Nigeria (Naira Billion)**

Items	2006	2007	2008	2009	2010
Gross Revenue	674.3	832.3	1,379.0	1,069.4	1,359.2
Recurrent Expenditure	398.2	683.6	819.4	704.6	823.7
Capital Expenditure	267.7	143.8	562.6	363.0	533.0
Current Balance	276.1	148.7	559.6	364.8	535.5
Over all Balance	8.4	4.9	(3.0)	1.8	2.5
Loan Financing	(8.4)	(4.9)	3.0	(1.8)	(2.5)
External Loans	—	0.2	—	—	—
Internal Loans	—	2.6	2.9	6.1	3.2
Opening Cash Balance	12.1	37.3	6.2	38..5	30.4
Others Funds includes Closing Balance	(20.6)	(44.9)	(6.1)	(46.3)	36.2
<b>TOTAL</b>	18, 709.6	20, 940.9	24, 665.2	25, 225.1	29, 498.6

**Source:** Federal Ministry of finance, Office of the Accountant general of the Federation, CBN/ NBS/ NCC 2010 Collaboration Survey and Staff Estimates of 685 returns of which 89 were provisional data out of 774 Local Government

The expenditure of the local governments was 27.1 per cent higher than the level in 2009 and represented 4.6 per cent of the GDP according to the Central Bank of Nigeria (CBN) report 2010. Recurrent Expenditure was an average of 60 percent of Gross Revenue from 2006 to 2010 while 40% was the capital Expenditure from the same period according to the CBN report

For local governments to serve the interest of people, they must have complete local autonomy in taxing and spending and they must be subject to competition within and beyond government. Local self-financing is important for strengthen governance, efficiency and accountability.

Although, Nigeria like most countries have opted for formula-driven fiscal transfers, the design of these transfers remains flawed. They do not create any incentive for setting national minimum standards or accountability for results and typically do not serve regional fiscal equity objectives either.

However, private sector participation in local government affairs should be encouraged through competition biddings, franchise operations with local government acting as a regulatory agency because the financial capacities of local governments are quite limited. Fostering private

sector participation in the delivery of local public services has assumed greater significance at the national and state levels. Such participation enhances accountability and choice in the local public sector.

### 3.0 APPRAISALS OF LAND USE CHARGE LAWS

Land Use Charge is defined in the Law 2012 of Oyo State as the amount payable on all property, **land based rates and charges** payable under the Land Use Charge. This is a consolidation of tenement rates and land charges on real property leased by government and other public agencies with different regulations guiding the operations and management of public and private estates. The Law also repealed Tenement Rate Law, Cap. 160 Laws of Oyo State, 200 meaning that **land base rates** include ground rents and tenement rates in conflict with Land Use Act.

#### 3.1 Conflict with Land Use Act, 1978

- (i) Whereas, section 5 (i) of the Land Use Act refers to land whether or not in an urban area granted by the Governor to demand rental for such land granted to any person and subsection (d) says to revise the said rental.
- (ii) Part III of the Land Use Act, Section 16 stated the principles to be observed in fixing and revising rents. Section 16(b) provided that the Governor shall **not** take into consideration any value due to capital expended upon the land by the same or any previous occupier during his term or terms of occupancy , or any increase in the value of the land the rental which is under consideration, due to employment of such capital.
- (iii) The position is quite different from Land Use Charge Law 2012 which states in Section 6(3) that “The amount payable as Land Use Charge Law shall be determined in accordance with the formula set out in the schedule to this Law thus:  $LUC = M \times [(LA \times LV) + (BA \times BV \times PCR)]$ . **This is a capital value approach to property tax assessment based on unit area-bases method.**
- (iv) Value of land is the capitalized value of ground rent or its rental. According to the Land Use Charge Law:  
LV = the average value of land parcel in the neighbourhood per square metres in Naira  
BV = the average value of Medium quality buildings in the neighbourhood per square metre in Naira

From the above explanation, section 6(3) of the land Use Charge which describes the value of the annual charge rate payable is in conflict with the provisions of section 16(b) of the Land Use Act if rental on land granted by the State Government is included in the Land Use Charge.

### **3.1.1 Sublease Under Land Use Act**

Under the Land Use Act, there are subleases granted by (i) Property Development Corporation at Bodija, Akobo and Olubadan Estates where the Corporation collect ground rents from lessees.

- (ii) That Local Government Councils collect ground rents on their Estates
- (iii) Ibadan Local Governments Properties Company Limited which manages Oluyole Estates, Olubadan Estates at Alegongo both Lagelu Industrial and Residential Estates in Oluyole and Ibadan South East Local Government Areas also collect ground rents on these Estates;
- (iv) Private Developers who are developing Housing Schemes in Oyo State as well as Industrial Schemes will also collect ground rents.

This would amount to a violation of the principle and practice of property taxation, if **Ground Rents** are included in Land Use Charges and it would also render the Ministry of Lands & Housing impotent in the management of Government Reservation Areas who are still charging and collecting ground rents on GRAs despite the Land Use Charge Law, 2012.

- (v) The provisions of section 49(i) of the Land Use Act, 1978 also stipulated that:

“Nothing in this Decree shall affect any title to land whether developed or undeveloped held by the Federal Government or any agency of the Federal Government at the commencement of this Decree and, accordingly, any such land shall continue to vest in the federal Government or the agency concerned.

In essence, all manners of land use and the cartels thereon subject to Land Use Charge does not include Land owned by Federal Government and its agencies

### **3.1.2 Authority to Levy and Collect Land Use Charge**

For the purpose of this Law which was a replica of Lagos State Land Use Charge Law, each Local Government Area described in Section 3(2) as the Collecting Authorities **may** delegate to the state, by written agreement, its function with respect to the collection of Land Use Charge.

The word “**delegation**” is not the same with the word “**appointment**”. The Local Government and the State Government cannot be Collecting Authorities under the same Law.

Therefore, section 2 and 3 of the Land Use Charge Law are in conflict. The fact that section 2 defined the Government of Oyo State as the Collecting Authority does not amount to delegation of authority by the Local Government.

### **3.2 Basis of Land Use Charge Assessment**

The per unit assessment relates the Land Use Charge liability directly to the size of the land and building. The rate per-unit area is derived from average values of group of properties within a given neighbourhood and may not reflect the characteristics of individual properties. The area-based method adopted has the following limitations:

- (i) First, the benefits from services are usually more-closely reflected in property values than in the size of the property. Moreover, market value has the advantage of reflecting the benefit of neighbourhood amenities, which are usually created by government expenditure and local government services.
- (ii) The unit area-based system offers opportunities for corruption. Valuation of the size and characteristics of properties are often grossly underreported because of collusion between tax payers and tax officials on self-assessment.
- (iii) Like all tax systems, the unit area-based system calls for sample audits, supervision of junior officers by more qualified senior officials, and a system of quick punishment for false declaration.
- (iv) A central valuation agency will help to establish standard value in a transparent manner and periodically undertake revision of tax base. The standardized value would provide a benchmark for judging the correctness of values declared in the sale and acquisition of properties.

### **3.3 Valuation Method Under Land Use Charge**

Determining the value of property is a critical aspect of property taxation as such value determines the amount of tax due. Various techniques may be used to determine value. Except in the case of property recently sold, valuation has some inherent subjective aspects. The value of property is often determined based on **current use** of the property, rather than **potential uses** of the property.

#### (a) **Who Determines Value?**

The value determinations are generally made by a **tax assessor** for the taxing authority. Property values are generally based on **fair market value** (FMV) of the property on the valuation date. Fair market value has been defined as that price a willing and informed purchaser would pay to an unrelated willing and informed seller where neither party is under compulsion to act.

The **sales comparison** method adopted in computing the **average value per square metres** is applicable to all property which is capable of being bought and sold in the market, but the important questions are the availability of adequate sales data and data for sale of identical properties within the same period of sales. **There is no two land or buildings exactly alike**. There is always a difference in location or amenities provided in buildings compared, if not also in age, occupational use, or neighbourhood character, and geniuses of sales for comparison.

#### (b) **Importance Of Locality/Neighbourhood**

In determining the fair market value of a property, the importance of locality cannot be ignored and must always be kept in view, when assessing Land Use Charge. After all, valuation is not and cannot be made in a vacuum. The Land Use Charge and generally property taxation requires the classification of land according to its location, amenities and housing density (i.e. Land Use Pattern).

#### (c) **Determination Of Fair Market Value**

In many cases, when it becomes difficult to resort to sale comparison to determine the market value, the India courts and valuers have adopted other methods or modes of valuation called “capitalization method” and “rental value method”. But these alternative methods to sales comparison must be resorted to only when the **fair market value** cannot be determined applying comparable sales method or sales analysis approach and not otherwise (D.N. Banerjee, 1998).

#### (d) **Time Factors Is Important For Comparison**

Time factors is an important aspect when considering comparative sale values. If the comparative sale is far too remote from the sale value acquired date then the sale should be approximately screened.

### (e) Valuation of special properties

The real estate properties are often stratified into group in which they can meaningfully be compared for valuation. The valuation of specialized properties such as Petrol Filling Stations, Hotels, Cinema Houses, Cold Rooms, the comparison sales method of valuation does not adequately reflect the income producing potential of these properties. These are investments properties that could be valued using income or rental value approach. This is also applicable to educational institutions. **These group of properties will bear the heavy burden of area based valuation using average sales comparison methods.**

### (f) The Term Assessed Value

The property tax system in principle and practice rests on a relationship among appraised value, assessed value, tax levies and tax rates. The same applies to Land Use Charge.

**Appraised value** = full market value =  $(LA \times LV) + (BA \times BV \times PCR)$  in practice.

**Tax Rate** = M as defined in Land Use Charge law 2012

**Assessed value** =  $(LA \times LV) + (BA \times BV \times PCR)$  in Land Use Charge Law 2012

**Tax Levies** = LUC or total amount of tax to be raised through Land Use Charge

Assessed values are usually based on the appraised or full market value of property for tax purposes as representing either the full market value of the property or a specified percentage of full market value (D.N. Banerjee, 1998). In less than 50 percent of States in the USA, assessed value is equal to market value. Whereas in more than 50 percent of the states the assessed value is a proportion of the full market value. Banerjee went further, *“whether assessments are at full value or a proportion thereof is usually a constitutional or legislative policy decision, not an administrative one”*.

With regards to Land Use Charge Law, **the assessed value is equal to full market value** of the property assessed. This is a heavy burden on the tax payers in both Lagos and Oyo States; hence the introduction of **assessment ratio** becomes imperative.

The state House of Assemblies in the two states should make assessed value a proportion of the full market value through legislative process. A percentage of 20% - 50% of the assessed value

$[(LA \times LV) + (BA \times BV \times PCR)]$  is suggested. Thus the Land Use Charge payable will be reduced. This percentage is called “Statutory Assessment Ratio”

### **3.4 Liability to Pay Land Use Charge**

Generally, liability for Land Use Charge or property tax payment is a choice between the owner of a property or the occupier of a property. Under the Law, the **taxable value** is primarily a function of the land and building area in square metres multiplied by average real property value in the neighbourhood.

Both the owner and the occupier are liable to pay property tax under the 1999 constitution of Nigeria. The **owner** of individual property pay “**withholding**” tax (10%) on rent received to the State Government while the **occupier or tenant** pay **Tenement Rate** to the Local Government where the property is located.

In Section 5 of Oyo State Land Use Charge Law, the owner of the property shall be liable to pay Land Use Charge in respect of any chargeable property.

However, the law empowers the occupier of a chargeable property to pay the Land Use Charge who is a tenant, and such shall be recoverable from the rent or other money due or, to become due to the owner.

This is not possible if the Land Use Charge is higher than the rent since the assessment is not based on the annual rental value of the property but on the average sales value of the area of the property. For example, a real property in Ibadan Municipality was levied to pay Land Use Charge for sum of ₦300, 000.00 when the tenant was paying ₦150, 000.00 rent in 2013, the occupier refused to pay and challenged the taxing authority on the basis of assessment.

### **3.5 Provision for Updating Tax Base**

The provision for updating assessed value of taxable property was not included in the Land Use Charge Law 2012. Consequently, the new Land Use Charge would be characterized by narrow tax base when new developments are not captured as real estate markets expand. which would eventually lead to the failure of the tax system to generate adequate revenues for planned expenditures. This will produce a climate of fiscal crisis, the most obvious symptoms being persistent inflation, itself a form of implicit taxation.

Periodic reassessment of the tax base is a fundamental issue in property taxation practice to capture the changing values of properties or keep pace with the growth of urban incomes. These also include change in value due to conversion and alteration of structures as a result of improvement in public provision of infrastructures.

The provision for updating assessed values takes one of the three forms:

- i) The less frequently used one involves yearly value updates, which are based on a sampling of property sales.
- ii) The more common provision is for a specified reappraisal cycle of every five years or ten years.
- iii) The other possibility is simply to index the property tax base as practiced in Brazil, Chile, and United Kingdom.

### **3.6 Tax Billing and Demand Notice**

The responsibility for collecting property tax which is applicable to Land Use Charge is clearly a very important one since affective collection performance is a vital element of a successful property tax system.

As mentioned earlier, section 3(2) of Oyo state Land Use Charge Law empowers each Local Government Area in the state to be the **collecting authority** and it shall be the only body empowered to levy and collect Land Use Charge for its area of jurisdiction.

Whereas section 10(1) authorized the Commissioner for Finance to issue in each financial year a Land Use Charge demand Notice with respect to every chargeable property that has been assessed in accordance with this law. Under section 10(2) the LUC demand Notice shall be delivered to the owner or occupier of the property.

The question then arises as to who delivers the demand Notice? Is it the assessor appointed under section 4 (2) or the Local Government whose authority to levy and collect has been taken over by the commissioner under section 10(1) of the law?

It is important in the principle of taxation to separate the assessment and collection functions to demonstrate impartiality on the part of those responsible for these two main elements of the property tax system which is applicable to Land Use Charge. However the **operational link** is needed to pass information between those responsible for assessment and those responsible for assessment and those dealing with tax collection.

### **3.7 Taxpayer Appeal Rights**

Section 16 provides that an Appeal shall not lie unless the prescribed fee is paid to the Assessment Appeal Tribunal. The prescribed fee was not stated in the law.

Under a normal appeal process, appeals are lodged first with a notice given in the prescribed manner to the body empowered to assess, in this case, the Commissioner for Finance in order that any errors made in preparing the assessment can be rectified for differences of opinion discussed and resolved through negotiation.

However, if such contact between the “appellant” and “assessor” cannot resolve the dispute, there may be need to have facility to refer the appeal to an **Independent body** which is the Assessment Appeal Tribunal provided for in section 13 (1) of the Land Use Charge Law. Section 15 of the Land Use Charge Law 2001 of Lagos State provided that an Appeal shall not lie unless:

- (a) Notice is given in the prescribed manner to the Commissioner for Finance.
- (b) The prescribed fee of 50% percent of the amount of the assessed Land Use Charge is paid.

The Commissioner should in essence set up a body for dispute resolution administratively and professionally on complaints arising from disputed assessment before further appeal to Assessment Appeal Tribunal.

### **3.8 Collection Enforcement**

The Land Use Charge Laws 2012 of Oyo State provided in section 18 for enforcement of **tax liabilities** at the magistrate court not lower than senior Magistrate Grade 1. Will the Commissioner for Finance apply to the court rather than by an Agency responsible for collection of Land use charge as provided for in section 3(2)

Interest penalties accrue at the rate of 10% for delayed payments between 45 and 75 calendar days, 25% between 75 and 105 days and 50% between 105-135 calendar days before the defaulter is charged to court.

Experience has shown that regular courts in Nigeria cannot handle tax matters because of delays and court procedures. That was why the Tenement Role law, cap 160 Laws of Oyo state 2000 amended in 2001 provided for the establishment of valuation courts to handle appeals and prosecution of rate defaulters. Nobody will be prepared to pay 50% of the Land Use Charge as a condition for appeal when the injustice could be redressed through dispute resolution mechanism put in place by the state government.

#### **4.0 INSTITUTIONAL FRAMEWORK FOR LAND USE CHARGE**

Designing and building the property tax database is a formidable challenge in developing countries and it requires intergovernmental and inter-agency cooperation. Weak or ineffective property tax systems can often be explained by reference to those charged with their upkeep failing to maintain them. Successful property tax systems and administrative procedures that are sustainable overtime

From an international perspective, the most successful property tax systems are those which have internal investment in system development and are maintained at the highest level (e.g. state government or in some cases, federal government).

Property tax administration develop to maturity over time in terms of the experience and professionalism of staff and the development of information technology to assist the administrative process.

The property tax administration is highly dependent upon the flow of information from other government departments and external agencies such as Department of Lands, Surveys Department, Physical Planning and Urban Development and the private real estate sectors.

Each country or state government must also make explicit decisions on which level of government will be responsible for each of the policy and administrative aspects of property tax systems.

The laws that govern property taxation are enacted by the State House of Assembly according to the Nigerian 1999 constitution property tax policy issues are highly centralized in the Ministry of Finance. The day-to-day details of administration are performed by the Central Valuation Office in line with the Tenement Rate Laws of various states.

The centralize process of Land Use Charge in Lagos and Oyo State do not have the support of local political leaders, because they were not involved in the process. Secondly, the centralized process ignored the economic and social differences among the local governments in both states. Finally, centralized policy making may not account for the administrative competencies of the local governments. Hence successful property tax implementation requires a strong role for the state government and the support of local governments.

#### **4.1 Function of Land Use Charge Office**

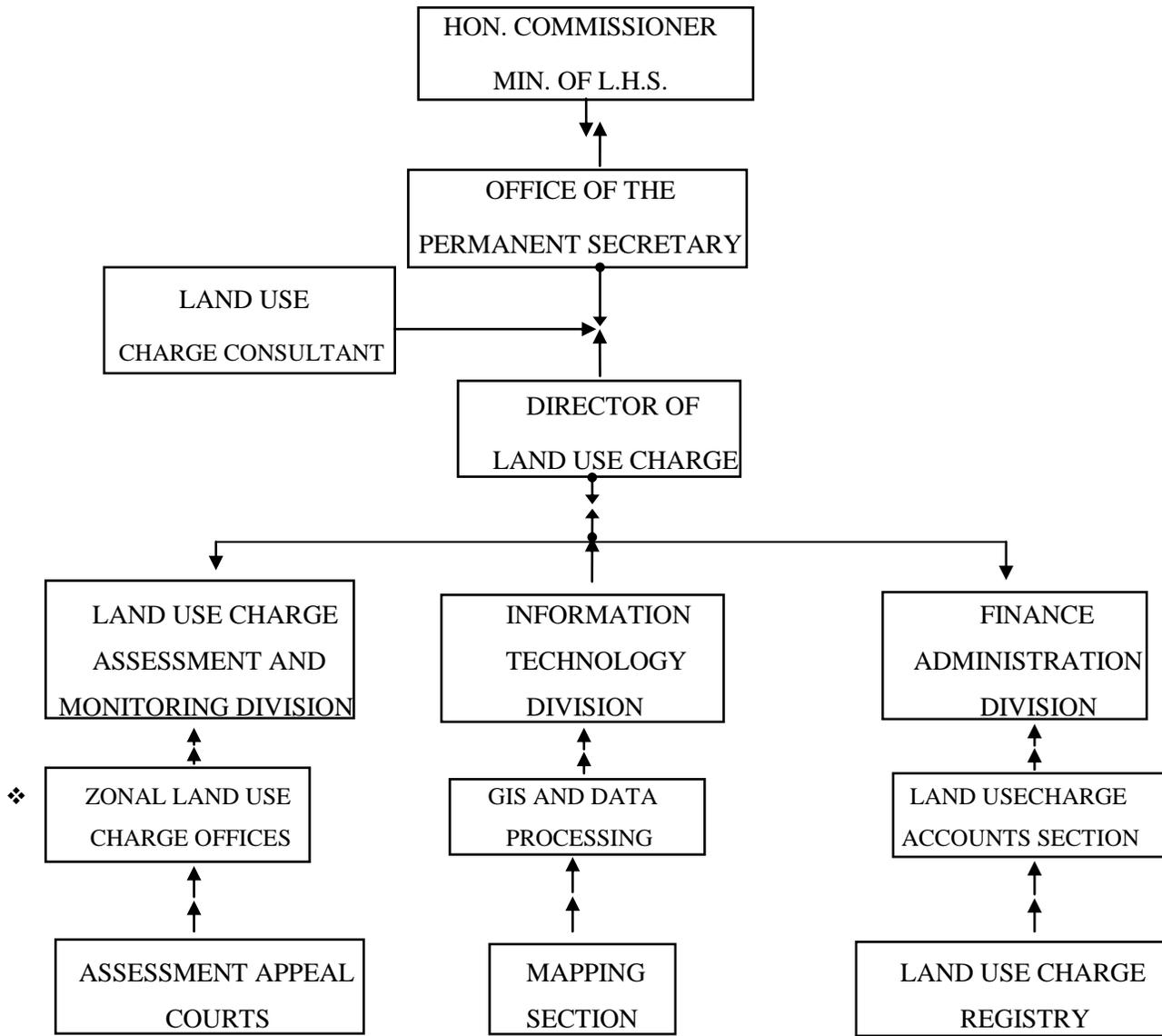
There is compelling reason to establish a Central Land Use Charge Office in a relevant professional through the reorganization and strengthening of the exiting Oyo State Valuation Office established in 1995 with the financial and expert assistance of the World Bank under the Oyo State Urban Project (IDF II) the head of Land Use Charge office must be a registered Estate Surveyor & Valuer to perform the following functions:

- (a) Set valuation standards for Land Use Charge assessment,
- (b) Carry out field work on identification and assessment of chargeable properties, and supervise appraisals engaged by government for the same purpose.
- (c) Delineate the township map into neighbourhoods for data collection and monitoring of Land Use Charges collection;
- (d) Updating of the tax base periodically;
- (e) Attend to complaints an property assessment of individuals and corporate bodies and
- (f) Supervise the ‘Collecting Authorities, that is, Local Government and render report

The appointed Consultants should not combine assessment function with the collection functions unless with the participation of respective Local Government Staff in order to develop their capacity to manage Land Use charge collection efficiently.

The Central Valuation or Land Use Charge Office will coordinate the Consultants operational activities and render reports to the appropriate authority.

## LAND USE CHARGE OFFICE ORGANOGRAM



### 4.2 Information Technology Division

Local authorities do not have the capacity to systematically maintain and coordinate their fiscal cadastre information (i.e. Valuation Roll), hence they depend on the State Rating Valuation Office in the Ministry of Local Government in Oyo State but in the Ministry of Lands in Kenya according to Roy Kelly (1999) to create and update their valuation roles. All fiscal cadastre information (i.e. Valuation Rolls) is maintained with the use of computers.

Property taxation is an ideal tax for utilizing computer technology to support property tax administration. Computer can be used to facilitate all aspects of administration. For example:

- a) Managing individual property information,
- b) Property valuation
- c) Tax assessment, (printing of field survey sheet)
- d) Billing system (printing of demand notice)
- e) Collection of tax (Delivery of demand notice)
- f) Enforcement process (record of Defaulters).

Successfully utilizing computerization depends on the ability to link the data processing activities with the administrative components of property taxation or land use charge. These two components must be effectively integrated to form a comprehensive property tax (or land use charge) administration management system.

The operation procedures such as the assignment and maintenance of unique property identification numbers, mapping, field data collection, valuation, bill delivery and monitoring, collection monitoring, enforcement and tax payer service must be integrated with the data processing components.

The data processing components include: data entry, verification and validation, valuation and assessment, tax billing, collection monitoring, system control and information retrieval. Ignoring the administrative components is a guarantee for computerization failure.

Maps should be used to ensure that all those listed properties have complete and accurate information necessary for rating purposes. The government must avoid the tendency to use property taxation to justify tremendous investment into computerized geographic information systems, which emphasizes the geographical components of digitized parcel mapping often based on a Global Positioning System (GPS). Are usually supply driven by the technology rather than demand driven by real needs of the property tax administration system. Expectations are usually not realized because these expensive high-technology solutions fail to consider all aspects of property taxation, especially its administration interface with tax officials and tax payers.

A computer-based geographic information system (GIS) is only needed for facilitating property identification, information analysis and tax map production would suffice for an ideal property tax administration.

### **4.3 Functions of Local Government Authority**

Section 3 (2) Local Government Area, for the purpose of Land Use Charge Law in Oyo State, shall be the ‘**collecting authority**’ and it shall be the only body empowered to levy and collect Land Use Charge for its area of jurisdiction. For this propose of carrying out these functions, the Local Government shall:

- (i) Set up collection machinery in the Local Government Estate and Valuation Department.
- (ii) Deliver ‘Demand Notice’ produced by the state to the owners of properties within its domain.
- (iii) Organize public enlightenment drive on Land Use Charge Collection with a view to soliciting and ensuring their co-operation.
- (iv) Keep records of ‘Demand Notice’ and tax payers served to be able to prepare the list of defaulters for prosecution.
- (v) Prepare reports and submit to the zonal Land Use Charge Office or directly to the Land Use Charge Office
- (vi) To generate and instill confidence in the Land Use Charge Collection through demonstration of probity and accountability in the collection, disbursement and use of funds generated, and
- (vii) Assist the Central Land Charge Office in the identification of taxation probabilities in each local government area

### **4.4 Capacity Building and Capability**

It is important to differentiate between capacity and capability. Capacity refers to the knowledge, skill and attitudes of individuals or groups and assigned to them. Capability on the other hand refers to the overall ability of the individuals or to actually perform the responsibilities. Local Governments Estate and Valuation Departments and the Valuation Office in the ministry of Local Government & Chieftaincy Matters are understaffed inspite of having the capacity to perform their functions.

It is essential that the design of training programmes must meet the objectives of delivering appropriate knowledge skills that can enhance the effectiveness of staff. Therefore, better capacity development depends crucially on better knowledge, as well as on appropriate skills and altitudes.

The enabling environment upon which the building of capacity is based is essential. Without a supportive policy and legislative framework, no local government valuation department and State Valuation Office will have capacity to work efficiently, including other ministry and departments involved in the tax administration, notwithstanding the capacity of individuals within it.

## **5.0 CONCLUSION**

The primary objective of government both at the national and sub-national levels is to raise revenue to finance its policies. Governments therefore need to balance the need to maintain political legitimacy with the fiscal imperative to raise revenue. Political interference can significantly affect the operation of the property tax to the extent that ordinary taxpayers lose confidence in the fairness of the tax.

Undoubtedly, real property tax will encourage more productive use of land, stimulate market activity by making real estate price information readily available to investors through land and sales transaction if properly registered and provision of updated cadastral maps.

However, the disadvantage of Land Use Charge is the centralized administrative functions by the policy makers which may not have the support of local political leaders because they were not involved. More importantly the centralized process has ignored the economic and socio differences among the local governments and their administrative competences in both Lagos and Oyo states of Nigeria.

In conclusion, the lesson learnt from principles and best practices of property taxation is that levying excessive tax on property beyond the annual return on property investments will be negating capital formation necessary for economic development and stuffing much needed funds away from real estate and housing in particular.

Moreover, excessive taxation will discourage business establishments, industrial and tourism developments in the country. For this not to happen, real property should be assessed by professionally trained tax assessors in line with Decree 24 of 1975 now cap. III NFL 1990 that established the Nigerian Institution of estate Surveyors and Valuers.

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