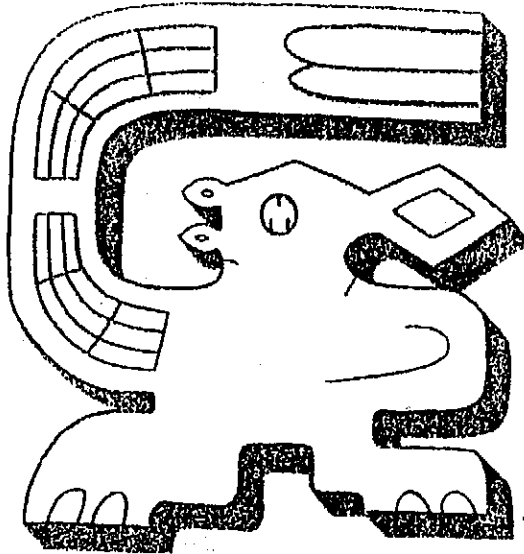


LTC Reprint No. 13



# Market-Enforced Self-Assessment For Real Estate Taxes

John D. Straszniak

*Prof. John Straszniak,*  
LAND TENURE CENTER

University of Wisconsin  
Madison, Wisconsin 53706

**MARKET-ENFORCED SELF-ASSESSMENT  
FOR REAL ESTATE TAXES\***

by JOHN STRASMA\*\*

**CONTENTS**

<b>I INTRODUCTION</b>	<b>B. Declarations by owners</b>
<b>A. The objective of this proposal:</b> accelerated reassessment	<b>C. Planning uses of declarations</b>
<b>B. Some things this proposal will not do</b>	<b>D. Enforcement</b>
<b>II LATIN AMERICAN EXPERIENCE WITH SELF-ASSESSMENT IN LAND TAXES</b>	<b>E. Options of the owner</b>
<b>III MARKET-ENFORCED SELF- ASSESSMENT</b>	<b>F. Inflation</b>
<b>A. A government agency</b>	<b>G. Disclosure laws</b>
<b>B. The private sector</b>	<b>H. Some procedural safeguards</b>
<b>C. Problems in forced sale</b>	<b>I. Getting started</b>
<b>D. Other objections</b>	<b>J. Corporations</b>
<b>E. Proposed solutions</b>	<b>K. Very large units</b>
<b>IV A NEW PROPOSAL</b>	<b>L. Payment terms for option a transfers</b>
<b>A. The first and most essential step: the effective tax increase</b>	<b>M. Land reform transfers</b>
	<b>V CONCLUSIONS</b>
	<b>A. The effective tax increase</b>
	<b>B. Appeal by self-assessment</b>
	<b>C. Appeal by appraisal</b>
	<b>D. Reassessment and land reform</b>
	<b>E. One final problem: a practical test</b>

**I. INTRODUCTION**

Few are the Finance Ministers in Latin America (and probably in other underdeveloped areas as well) who have not longed for increased revenue from real estate taxes. Inflation

\* Revised English version. I am greatly indebted to students and colleagues who have criticized earlier drafts. Gonzalo Arroyo, Solon Barraclough, Juan Braun, Robert Brown, Arthur Domike, Peter Dorner, Eduardo Garcia, Francisco Garcia H., Keith Griffin, Carlos Hurtado, Dino Jarach, Mateo Kaufmann, Fernando Mateo, Pedro Moral López, Roberto Maldonado, José Pistono, E. Rlofrio V., Daniel Stewart, William Thiesenhusen, Hugo Vega, and my students in the University of Chile's Graduate School of Latin American Economic Studies (*ESCOLATINA*) all commented on drafts in Spanish circulated in 1964 by the Instituto de Economía of the Universidad de Chile.

Several of these, as well as Richard Bird, Rudolph Blitz, Vincent Brett, John Copes, Alejandro Foxley, Arnold Harberger, Bruce Herrick, Karl Lachmann, Oliver Oldman, Daniel Schydrowsky, and Ronald Welch made further valuable comments on an English draft circulated in April 1965 by the Land Tenure Center of the University of Wisconsin. They have aided enormously in spotting problems and clarifying issues. Many remained skeptical of the whole idea, however, giving added force to the usual warning that I alone am responsible for what follows.

\*\* Visiting Professor, Land Tenure Center and Department of Agricultural Economics, University of Wisconsin. This study is supported in part by the Land Tenure Center, a cooperative research and training program of the Agency for International Development, the American Nations and the University of Wisconsin and is published by permission of both the author and the Land Tenure Center.

and population growth without corresponding increases in property tax values have reduced this traditional revenue source to insignificance, both in total revenues and in its economic impact on property owners.<sup>1</sup> Could it not again become an important source of tax revenue, helping finance urgent development programs or reducing the inflationary pressure of unbalanced budgets? Could it not create a pressure tending to the more efficient use of urban and rural land? Where the real estate tax is a source of revenue for local governments, could it not greatly improve the ability to solve local problems, aiding both development and "grass roots" democracy?

The most conspicuous bottleneck in Latin American economic development has been the agricultural sector, whose output has not even kept up with population growth. Population is growing at 2.7 to 2.8% annually, yet total farm production has averaged only 1.6% annual growth over the last five years.<sup>2</sup> Per capita food production in 1963/64 was actually 3% below the level of a decade earlier, and the trend is downward.<sup>3</sup> Yet there are notoriously large quantities of privately-owned agricultural land idle or grossly under-utilized in relation to available labor and existing demand for agricultural products.<sup>4</sup> One symptom of this problem is the dramatic contrast in the value of output per hectare of agricultural land. For six countries included in the "first-round" CIDA studies, family units (those occupying 2.0 to 3.9 persons) averaged three times the production per hectare of the large multi-family units (employing over 12 workers).<sup>5</sup>

There are many hypotheses as to just why this land is under-utilized, but heavier taxation could theoretically overcome many of the presumed causes. If it were possible to levy a heavy annual tax on agricultural land, idle land would be put into production or sold, land prices would fall, traditional tenure structures would become more flexible, and both output and employment should rise considerably. These changes would all be steps toward the objectives of agrarian reform, and the added revenue would help finance development projects or programs.

Too, a large part of private wealth in underdeveloped countries is typically invested in land and in urban construction. Given the practical and incentive difficulties of implementing effective progressive taxes on income and profits, are not higher real estate taxes the most feasible way to achieve a mild redistribution of wealth, and to encourage equity investments in enterprises?

1 The present state of property taxation in Latin America was discussed at two international conferences on taxes, held in Buenos Aires (1961) and in Santiago (1962). The Proceedings are available (in Spanish) from the Joint IDB/OAS Tax Program, Pan American Union, Washington, D.C.

2 Inter-American Development Bank, Social Progress Trust Fund, *Fourth Annual Report*, 1964, p. 107.

3 FAO, "The State of Food and Agriculture, 1964," Rome, 1964, p. 16. Quoted in Inter-American Development Bank, *op. cit.*, p. 108.

4 This long-standing observation by scholars doing field study appears to be consistent with the findings of ICAD research reported in FAO, "Agrarian reform policies," a paper prepared for the Latin American Conference on Food and Agriculture, Viña del Mar, 1965. ICAD, better known by its Spanish initials as CIDA (Comité Interamericano de Desarrollo Agrícola), is an association of five international agencies working to aid Latin American agriculture: ECLA, FAO, IDB, IIAS, and the OAS.

5 Calculated from provisional CIDA data reported in FAO, "Agrarian reform policies," table 3, for Argentina, Brazil, Chile, Colombia, Ecuador, and Guatemala. Idle land on very large properties is, of course, only one of several factors accounting for the output differences.

*A. The objective of this proposal: accelerated reassessment*

Efforts to increase property taxes in underdeveloped countries are naturally resisted by the landowners, as well as by others who aspire to more drastic changes, and therefore do not want the incumbent government to solve any of its problems. Most frequently, however, these tax efforts fail because it is physically impossible to revalue real estate in the fleeting period (often one year or less) during which a president, finance minister, or political party typically enjoys the power *and* has the will to raise property taxes effectively.<sup>6</sup> The opposition generated is tremendous but takes time to get organized. Therefore, a rapid revaluation has some chance of success, but a careful, painstaking reassessment effort by traditional means is likely to be abolished or compromised into innocuousness before the planned effective date.

This article describes techniques—chiefly index number adjustments and owner self-assessment enforced by private offers to buy undervalued properties—by which tax values could be brought close to market values, rapidly and yet without intolerable injustice or inequity among owners. These tactics should succeed despite gross inadequacy of tax valuation personnel, equipment, vehicles, budget, etc., when measured against the demands of traditional assessment and reassessment methods.<sup>7</sup>

In addition, the approach here suggested is compatible with longer-term programs to upgrade valuation staffs and to carry out cadastral surveys. Practical technical assistance experience shows that it takes five years to get into full stride and ten to finish, with firm political support throughout that period.<sup>8</sup> In fact, if such long-term projects are undertaken, the measures here proposed will increase revenues meanwhile, helping cover the cost of traditional appraisals. Since land values will already be near market prices, landowner resistance to the new survey may even be lessened.

*B. Some things this proposal will not do*

Many novel economic policy recommendations made to underdeveloped nations by "expert" advisers err by attempting to resolve too many problems at once. Criticism of earlier drafts of the present proposal stressed its failure to solve various pressing problems of underdevelopment or to eliminate all corruption in the tax service. The present proposal is not a panacea. All it aims to do is to reassess a country's (or a municipality's) real estate for tax purposes, rapidly, effectively, inexpensively and justly.

6 A rate increase is seldom a satisfactory substitute. Congresses are not likely to accept increases of 300 or 400 %, though reassessments often average 1/3 or 1/4 of market value. Reliance on rate changes perpetuates injustices among owners and does not catch properties not now assessed at all. And continued underassessment hampers application of taxes on income, capital and inheritances, and reduces the theoretical progression in rate schedules.

7 Traditional assessment and reassessment are here understood to mean at least the preparation of a rough plot, inventory of taxable improvements, crude field measurement of farms or of urban buildings and an individual calculation by a tax valuer, of an assessed value for each property unit. The principal problems are establishing unit values or other guidelines, corruption, and the sheer physical task of inspecting every unit. Detailed instructions for the organization, training, and implementation of a traditional reassessment in an underdeveloped country may be found in the United Nations' forthcoming *Manual on Land Tax Assessment*.

8 Mr. John Brett, conversation with the author at U. N. Headquarters, February 1965.

Heavier land taxation, however achieved, will not—for instance—do much to redress the unequal bargaining power of landlord, tenant, and landless laborers. It will thus not achieve that massive redistribution of wealth, opportunity, and social structure sought in land reform. Heavier land taxes could even lead to the demand—by landlord or by tenant—of even harder labor at even lower wages, although this might indirectly favor reform by building up resentment and workers' willingness to take the risk of agitating for reform.

In the cities heavier taxation of land could accelerate construction of some kind on the vacant lots now held off the market for speculative purposes, or as inflation hedges. This may lead to overbuilding or to the wrong kind of construction as seen by planners. Cities will be more pleasant places in which to live if some space remains open (hopefully, in parks). Also, assuming that the buildings are themselves taxed, a heavier tax may lead to overcrowding, unsafe building practices, or unaesthetic architecture. This proposal cannot substitute for competent city planning and zoning, although the resulting increased revenue could perhaps finance the planning agency heretofore considered an impossible luxury.<sup>9</sup>

Just as it cannot substitute for land reform, nor for urban planning, this proposal cannot eliminate all forms of corruption in public administration. The procedures suggested seek to reduce the opportunity for corruption in tax administration, principally by drastically reducing the number of properties to be appraised by public employees. Incentives are provided for the correction of unduly low tax assessments upon the initiative of private individuals. Less skill is required of the staff who may therefore be more content with public employees' salaries than are highly-skilled appraisers. In fact, the procedures suggested are simple enough that much of the work can be done by employees shifted temporarily from other duties. But if 100% of the employees of an agency are dishonest, neither this nor any other procedure is likely to succeed.

Likewise, if there is anarchy—no government officials and control at all in some zones—neither this nor any other proposal is likely to implement a land tax in such areas. The present proposal, however, can certainly be implemented more quickly than traditional reassessment techniques, once an area is recovered.

Finally, this proposal will not lead to unemployment for the appraisers and lawyers who are overworked—but often doing quite well personally—under traditional assessment practices in underdeveloped countries. They are still needed to appraise certain complex properties (see paragraph 13 below). They are often needed as valuers in land reform and urban housing programs. In almost every underdeveloped country the lawyers who now thrive on representing landowners contesting tax assessments could perform a socially more useful service. They are needed in government programs to clear titles for thousands of squatters, colonists, and other small farmers whose credit,

<sup>9</sup> This proposal will not remove all the distortions produced by rent control, in underdeveloped countries, or in New York City. In fact, governments must not be persuaded to allow landlords to pass on higher taxes in rents, lest tenants as well as homeowners join the fight against tax reform. Far better would be first to increase the supply of low-rent housing, then end rent control, and *then* raise taxes "to capture for the community landlord profits from the end of rent control."

welfare, security, and incentives are undermined by uncertain title to the public lands they till.<sup>10</sup>

## II. LATIN AMERICAN EXPERIENCE WITH SELF-ASSESSMENT IN LAND TAXES

Ideally, every country needs a cadastral survey. Revenue considerations apart, it aids agricultural planning at all levels and most claims to land, water, and improvements tend to be defined and registered in the process. Thanks to aerial photography and photo interpretation, Chile recently completed a reassessment for some 200,000 rural properties in a record three years as part of such a survey.<sup>11</sup> The project was greatly facilitated by the relatively high competence and morale of Chile's Internal Revenue Service and by foreign loans, grants, and technical assistance supplied originally to help plan reconstruction following the 1960 earthquake.

For many countries, however, scientific reassessment is too expensive and takes too long, even with the aid of modern techniques. Short cuts must be found. Most Latin American nations undertaking reassessments have concentrated on city property and allowed or even ordered rural landowners to declare the value of their own land, usually under oath. This is rapid, costs little, flatters the owner's belief that no one else knows his property as he does, and in any event is the only way to get any valuation at all for many rural properties, given the very limited budget and lack of vehicles for the revenue services in most countries.

In practice, these self-assessments have been unsatisfactory, although the best possible under the circumstances. No owner wanted to pay more than his fair share in relation to others and many were quite willing to pay less.<sup>12</sup> Tax values for similar properties varied widely. Although tax inspectors had legal power to challenge the values declared, they usually did so arbitrarily or not at all.

Some governments attempted to obtain more honest declarations by threatening that in the event of expropriation for public purposes or for land reform, compensation would be limited to the amount declared by the owner as the value for tax purposes. In other cases, banks were supposed to limit mortgage loans to fixed percentages of the tax valuation. Such threats were made in Cuba and Colombia for years; the mortgage limit is reported to have been used in Central America.

<sup>10</sup> Dr. Enrique Peñalosa, Manager of the Colombian Agrarian Reform Institute, justly stresses the contribution made by his teams of lawyers who were able to clear and issue 10,434 titles (to a total of 528,000 ha.) in 1962 and 1963 to the tillers of public lands. INCORA, *Segundo Año de Reforma Agraria*, Bogotá, 1963, p. 8.

<sup>11</sup> Details, including costs, are included in J. Strasma, "Técnicas de tasación y la planificación fiscal en Chile," in a collection of essays being published by the Instituto de Economía of the Universidad de Chile in 1965. An English version of this paper will be prepared if there is sufficient interest; inquiries should be directed to the Land Tenure Center, University of Wisconsin.

<sup>12</sup> The landowners' interest in underassessment is even greater when the income tax includes a presumption as to income from land related to its tax assessed value.

Naturally, landowners cannot be guaranteed payment of any price declared, no matter how high. Expropriation proceedings may still include a formal valuation—but actual compensation may not exceed the most recent tax value, plus the value of improvements exempt from taxation or added after the last tax declaration was filed. This is the form of the law currently applied in Colombia, for example.<sup>13</sup> If such stipulations were omitted, landowners might become still wealthier city dwellers by overvaluing their properties, paying taxes for one year, and then abusing tenants or laborers until they strike, seize the property, or otherwise force the government to expropriate the property.<sup>14</sup>

Such "declarations of value in the event of expropriation" will actually approach true commercial value if, and only if, landowners are convinced that agrarian reform is a reality, and that it will actually expropriate their lands in the near future. If the expropriation threat is not credible, self-assessment will fail. If the land reform agency has no funds, if the Constitution must be amended before land can be expropriated with payment in bonds, or if for any other reasons land reform seems remote, the threat will not be credible. Owners with confidence in their political relations in the capital will not fear expropriation or will be confident of advance warning that will allow them to declare much higher values before expropriation proceedings begin.<sup>15</sup>

From a fiscal viewpoint, self-assessment techniques will be useless for the small property whose owner has no reason to fear expropriation. They are equally unpromising in countries where land reform has supposedly already happened once-and-for-all (e.g., Mexico and Bolivia) or where important Government figures assure landowners that it is not even needed (Argentina?). And they will not work for properties up to the size limit that large owners are usually permitted to reserve for themselves and their sons. Since these parcels are exempt from expropriation, the threat is not credible.

### III. MARKET-ENFORCED SELF-ASSESSMENT

The original problem is still unsolved: whether for revenue purposes or as a land reform measure, or both, how can underdeveloped countries obtain up-to-date property tax assessments rapidly and at low cost, without adequate valuation departments. Or, how can this be done even approximately, before and during the five to ten years required to organize and complete a reassessment even with the aid and help of technical assistance programs?

Self-assessment, in which the owner does most of the work of identifying, describing,

13 Decreto 2895 of 1963 and the reglamentary Decreto 181 of 1964. Owners may file new declarations once every two years. The first such opportunity ended on February 29, 1964; 12,298 declarations were made. This was less than 1% of all rural properties, but they accounted for 10% of previous assessed valuation. The average value declared was double the existing assessments; the total rural property tax base rose from 18,771 million to 26,495 million pesos. I am particularly grateful to Richard M. Bird for help in obtaining and evaluating these figures.

14 I am indebted to E. H. Jacoby for this observation.

15 Albert O. Hirschman, *Journeys Toward Progress* (New York: Twentieth Century Fund, 1963), pp. 116-138, attributes the failure of self-assessment in Colombia, at least prior to 1963, to these reasons.

and evaluating his property, still seems to be the only approach possible for most underdeveloped countries. The success of the system depends, however, on making the threat of having to sell at the declared value credible to all owners.<sup>16</sup>

*A. A government agency*

One approach might be to create a government agency to buy (and resell) property of any size which it deemed to be grossly undervalued. Such an agency should be able either to produce substantial profits for the state or to frighten owners into making honest declarations—provided the agency has honest and efficient management. However, it would be hard to justify taking such personnel from existing agencies, including the revenue service, where they are badly needed if development plans are to succeed.

The experience of many governments when real estate dealings are involved—including some U.S. cities—suggests also that such an agency might soon be corrupted. On the one hand, political pressure or bribery might be applied to force the manager to buy property on which values well over market prices had been declared; the owners would become rich, but the agency would soon be insolvent. On the other hand, landowners holding congressional seats or otherwise politically powerful might reason that no government employee would dare touch *their* lands, no matter how shamelessly undervalued.

The weakest link in the government realty agency as an enforcement technique is precisely that it is part of the government, yet the appreciation of market value is essentially subjective and even in part intuitive. An employee who had been bribed or pressured to buy or to ignore a specific property could not be detected; he would always be able to state that in his opinion the price was reasonably declared. Much the same problem prevented control of the old systems of fiscal appraisers and inspectors who were supposed to make inspections and revise self-assessments upward as needed, even where vehicles and staff were available for field trips.

*B. The private sector*

The remaining possibility, then, is somehow to enlist help from the private sector. In centuries past, sovereigns often authorized individuals or companies to assess and/or collect various kinds of taxes for a percentage of the revenue.<sup>17</sup> In extreme cases the collectors were obliged to remit only a flat sum, keeping as profit everything additional

<sup>16</sup> Mr. John Copes has suggested an alternative in correspondence over an earlier draft. Owner honesty would be obtained by threatening a stiff fine should subsequent professional assessment come up with a value much higher than that declared. In Latin America, at least, this would merely increase the vested interest of landowners in blocking reassessment. To put the new values into effect, the government would have to condone the fines after all, as hardly anyone would take this sort of threat seriously, hence all would be affected.

<sup>17</sup> A variant of this system persisted in Peru until it was eliminated by President Belaunde in 1963. Collection was handled by a bank-owned enterprise for a percentage of taxes collected. The banks at times advanced money, at interest, against future receipts. Some critics believed that the banks already had the money in their rural offices and delayed in remittance in order to earn interest by lending the government what amounted to its own money. (Conversation in the Finance Ministry in early 1961).

they could take from the taxpayers by fair means or foul. Such "tax farming" is hardly an acceptable solution in the middle of the 20th century, however.

A far more promising suggestion was made by Arnold Harberger in 1962, to the Santiago Conference on Fiscal Policy sponsored by the Organization of American States, Inter-American Development Bank, and the Economic Commission for Latin America. Harberger suggested that the threat of purchase at tax value would become credible if private citizens, as well as the state, were allowed to buy real estate at the price declared by owners, plus some margin (say, 20%) of profit for the owner.<sup>18</sup> Participants in the conference generally rejected the idea, chiefly objecting to forced sale to another person even with a profit margin.<sup>19</sup>

### c. *Problems in forced sale*

Forced sale is generally accepted as a necessary evil when land is needed for public purposes; this has been extended to include the expropriation of land for urban renewal or agrarian reform, even though it is subsequently sold or given to other private citizens.<sup>20</sup> For "mere" under-declaration of taxes, however, forced sale seems to be excessive punishment, especially for owners who declare in good faith, but simply are ignorant of the current value of their property.<sup>21</sup>

Harberger assumed implicitly that everyone ought to be perfectly happy to sell any of his property, to anyone, at any time, for some price, and that he should pay taxes on that price. Some critics defended the right of a man not even to consider at what price he *would* be willing to sell, when it is a matter of the family home for the last 5 generations. Most, however, felt that the tax should be based on the market value assuming a willing seller and an informed buyer, rather than on a value sufficiently higher to overcome the seller's reluctance or inertia. They could have found a useful precedent, in the fact that expropriation indemnities are often set explicitly at market value, ruling out sentimental and other non-market losses felt by owners.<sup>22</sup>

One critic feared the "insecurity" which the system would cause owners, and another feared that investment would be greatly discouraged.<sup>23</sup> The real problems here are whether the system will work if owners can somehow escape forced sale, and whether

18 "Aspectos de una reforma tributaria para América Latina," *Documentos y Actas* (Washington: Pan American Union, 1964), pp. 183-185.

19 The discussion is summarized in *Documentos y Actas, Ibid.*, pp. 197-204.

20 Oliver Oldman, in a letter commenting on an earlier draft, pointed out that it would be "a vast extension of the public purpose notion to allow one private party to obtain another private party's property for the purpose of assuring "good" property tax administration."

21 Readers who question whether most owners are really unaware of property values should bear in mind that many Latin American legislatures and judges are still reluctant to deal as harshly with willful income tax evaders as with pickpockets or chicken thieves. An unbounded presumption of good faith favors the solvent citizen. This is one more reason why other citizens may be more efficient tax enforcers than government employees and the courts.

22 For example, in the Venezuelan Land Reform Law of March 19, 1960, article 25.

23 Respectively, Carlos Matus and Ifigenia M. de Navarrete, *Documentos y Actas, op. cit.*, pp. 193 and 199.

improvements should be included in the property tax base at all.<sup>24</sup> (Of course, if land titles are really uncertain, as with squatters or Indian communities, improvements are the only property that can be taxed at all.)

If new buildings, etc., are to be tax exempt during 5 years, for example, it would be necessary to require their declaration, with proof of cost. The owner would also declare the total price which he would want to receive for the property, including improvements. The differences would be the value assigned the land; this amount would be taxable, but any offer would have to include the entire amount for land plus exempt improvements.<sup>25</sup> One great advantage of self-assessment enforced by the market, however, is that it removes the complexities of depreciation policy from the valuation of improvements. The owner uses historic cost, replacement cost, or whatever he likes—but if he strays far below true current market value, an offer brings him back into line.

#### D Other objections

Richard Goode observed at the Santiago Conference that landowner rights would be abused under Harberger's scheme, because "insiders" would learn of proposed high-ways or other developments that would raise land prices in a given area and would buy up the land at present market values through the tax-enforcement mechanism.<sup>26</sup> Insiders do this now, however. This objection falls in the class of those made by persons who reject the proposal not for any great defect as it stands, but because it fails to solve unrelated problems which bother them. In this case, the real problem obviously is to make sure that such windfall gains are instead collected by the community through betterment levies and capital gains taxes.<sup>27</sup>

Another critic also criticized Harberger's proposal as "apparently simple, but impractical," only to suggest that the state correct assessed values by raising them when a property was sold for a higher price.<sup>28</sup> The critic's alternative is certainly itself "simple, but impractical," for transfer prices are notoriously underdeclared to evade transfer taxes in most countries.<sup>29</sup> In addition, the hacienda owners who never sell any land,

24 In my own opinion, improvements should be taxable, except for possible temporary exemption of truly low-rent housing meeting minimum quality standards, and major factory installations. Machinery and motor vehicles should be taxed; the former in part to offset a tendency to overmechanization in terms of social opportunity costs of labor and foreign exchange in Latin America. Licensing and credit are generally more effective than tax exemptions in stimulating and orienting investment. See, for instance, Albert Lauterbach "Government and Development: Managerial Attitudes in Latin America," *Journal of Interamerican Studies*, April, 1965, pp. 201-225.

25 There would, of course, be possible evasion through over-valuing of exempt improvements; these should perhaps be held to cost or book value as accepted under income tax depreciation rules. Also once the fiscal appraisers are caught up on other work, they could give first attention to official, definitive assessment of properties whose owners claim large exemptions. See paragraph 50 below.

26 *Documentos y Actas, op. cit.*, p. 201.

27 A point on which Mr. Goode agrees completely.

28 Carlos Matus, *Documentos y Actas, op. cit.*, p. 193.

29 Matus himself admits this; *Ibid.* In addition, as the exception that proves the rule, we might note Venezuela, where the absence of a transfer tax and the influence of recorded prices in fixing land reform compensation seems to lead to over-declaration!

transferring it only within the family, by inheritance, would be immune from the system.

Above all, this critic objected to anyone's realizing a private profit from ending someone else's tax fraud. This thought appeared to disturb him more than the evasion itself.<sup>30</sup> Other remarks suggest that perhaps this critic was not even interested in achieving an effective property tax, because it would end a privilege of the rich which now can be pointed to as a reason for overthrowing the present form of political and economic organization. Just like the typical spokesmen for the rich, he insisted that assessments should not be fixed in any simple way, nor by any one functionary, but rather by an entire commission, with various opportunities for owners to appeal to the courts, etc.<sup>31</sup> Yet most of those present at the conference agreed that this traditional system was not working in Latin America and had numerous flaws in richer countries able to afford large, well-equipped tax services.

#### E *Proposed solutions*

Even if we reject the strangely similar criticism of those motivated by a vested interest in private property—or in its elimination—there are still serious problems in Harberger's scheme. Inevitably, there will be some citizens who do not wish to sell their property now at any price. They might suffer forced sale even if they declare full market value, simply because someone dislikes them.<sup>32</sup> They might also be subject to extortion by someone threatening to make an offer which would force them to move.

As an alternative to forced sale, Nicholas Kaldor then proposed that owners be permitted to retain their properties after an offer, provided they accepted a new tax assessment even higher than the offer they rejected.<sup>33</sup> Harberger reluctantly accepted this variation, provided owners were also fined, to discourage them from undervaluing until such an offer were made. However, he pointed out that the system would be weaker because it assured the owner that he could in some way escape forced sale and because the probable refusal of the owner to sell would eliminate all incentive to others to appraise the property and make an offer if it were declared for much less than the market value.<sup>34</sup>

Thus we return to the question of "security" for property owners. Those who invoke it most frequently seem, when pressed, little mollified when an escape is provided subject to a penalty. Apparently, and this is especially frequent among lawyers accustomed to defending clients against tax authorities, what they really seek is "security" against

30 Matus, *loc. cit.*

31 *Ibid.*

32 Americans can visualize the use of the system by persons seeking to break, or to preserve, residential segregation by races.

33 *Documentos y Actas, op. cit.*, p. 202. In all fairness, we must note that Kaldor, Harberger, and Matus presented other substantial contributions to the Santiago meeting; this particular scheme was a relatively minor part of their respective participations.

34 *Ibid.*, p. 204. In his paper, Harberger also proposed that if adoption of his scheme were frustrated by the "lawyers," assessors could themselves be rewarded or fined according to how closely their assessments came to the actual prices at which property was subsequently sold. But how to determine true transfer prices? (See note 29 and corresponding text above.)

JOHN STRASMA

having to pay any significant tax on property. But the security we seek is another kind: security for the honest taxpayer, that others are also paying the taxes specified by law and that if their property is worth as much as his, they pay as much in taxes. And security for the finance minister, that he has an effective, just, practical revaluation, despite the well-known deficiencies of his tax service. If we can achieve this security, without forcing anyone actually to lose his property for false declaration, we are being merciful. But to keep down the number of would-be tax evaders, we need a secure incentive for the enforcers. This, then, will give the evader the final security: that he will probably be tripped up and suffer a fine.

IV. A NEW PROPOSAL

The only hope for effective reassessment in poor countries lacking a large, honest, competent, and well-paid professional appraisal staff equipped with manuals, vehicles, etc., is to somehow enlist private individuals. Persons with knowledge of the market and a personal economic interest in the outcome can make fairly good decisions as to whether a given property has been declared at about the price it would bring in quick sale on the market.<sup>35</sup> The problem is to find a way to enlist persons qualified to make such judgments, without abusing the moral and constitutional rights of the innocent and of the inadvertent underdeclarer.

In particular, a way must be found to allow those who do not wish to cheat, but who do not know what their property is worth, to avoid forced sale. The system would also be more acceptable if those who did under-declare, even deliberately, could be punished in some way short of forced sale, without eliminating the incentive for the other person who enforces honest declarations by making offers.

Kaldor's suggestion eliminated the unjust forced sale by substituting an option to accept higher taxes. To discourage initial under-declaration, awaiting an offer, the owner should also be fined as suggested by Harberger<sup>36</sup> or the tax increase could be made retroactive for (say) three years. Next, the missing incentive element can be supplied by paying part of the tax increase and fine to the person who appraised the property and demonstrated his confidence in his valuation by making a bona fide offer to buy at a price well above the tax value declared by the owner. Even after sharing the tax increase, the government has gained substantially in present and future revenue, as compared with the permanent underassessment that is virtually inevitable with traditional methods.

It now appears that self-assessment could be made workable, even under present

35 It is true that private appraisals, at customary honoraria, cost more than appraisals made by public employees—unless the latter set lower values through sloth or corruption, which cost through reduced tax revenues. In any case, the private appraisers are often under-employed, the tax workers overworked. The 'social opportunity cost' of the time of the private individuals involved may be very low. In any event, we propose to obtain their services at no cost to the government. Their fees, in effect, will be paid by tax evaders.

36 *Documentos y Actas, op. cit.* p. 204.

deficiencies in tax administration and despite the imperfection of land markets in much of Latin America. With the aid of numerous friends, students, and colleagues, most of the remaining problems—and others that appeared in the road—seem to have been resolved.<sup>37</sup>

The first requisite, as under any assessment technique, is still that the government genuinely desire reassessment near market values. The second is that it have the will (and votes or rifles) to overcome the inevitable opposition of property owners, often allied with extremists who simply do not want to permit real solution of any problems by moderate governments. Given these two pre-conditions, the present form of the proposal appears to be practical, effective, and fair to all concerned. It would operate as follows:

A *The first and most essential step: the effective tax increase*

1. All existing assessments are arbitrarily multiplied by a factor which is expected to put the average assessment at about 'true market value.' If any rate reduction is contemplated, it should be reserved as a 'concession' to be made to the property owners once they exert organized pressure and—typically—threaten a massive taxpayer strike. Most Latin American rates, however, are far below the 2 to 4% effective rates on market values typical of the U.S.<sup>38</sup> Yet large real estate owners are often relatively higher in the distribution of their country's wealth than are landowners in the U.S.A. Despite the poverty of their workers, many Latin landowners could therefore well afford U.S. rate levels.

2. This is, after all, the effective increase in taxes. If it is rammed through first, the landowner bloc is divided; many then stand to gain through reassessment. So long as the tax increase is delayed pending reassessment, reassessment will be resisted and sabotaged at every turn. Since the power and the will to impose reforms on the vested oligarchies is usually fleeting, found only at the very outset of reform regimes—whether elected or imposed through coup or revolution—the effective tax increase must be the very first step.

3. Determination of the multiplier should normally take three factors into account: general inflation; rising income-producing value of real estate as a result of population increase, roads, and other aspects of economic growth; and, the average initial under-assessment of property. The first element can be estimated from price indices if available, or from exchange rates. Since the other two factors are invariably positive, the

<sup>37</sup> Most of the practical touches in the present proposal grew out of post-conference conversation with Harberger, Albert Hart, Kaldor, Carlos Massad and José Pistono. The proposal first appeared in something like its present form in Strasma, 'Aspectos financieros y tributarios de la reforma agraria,' *Reforma Agraria* (Santiago: Instituto de Economía of the Universidad de Chile, January-March 1963), Vol. III, pp. 158-160. See also the acknowledgements in the note on p. 1.

<sup>38</sup> The problem is not limited to Latin America. Wilfred Lewis, Jr., mentions that the Afghanistan land tax in some areas was only 1/100 of 1% of land market values. The tax rate was doubled recently, but 'more ambitious measures' are to be submitted to the next Parliament. ('Approaches to Land Taxation,' unpublished manuscript, and correspondence with the author.)

multiplier should always be greater than the inflation adjustment alone." How much greater may be estimated by comparing existing tax valuations with the court-determined figures for the same properties in inheritance tax proceedings or in cases of expropriation for public purposes. If there are any reliable market prices for recent property sales—at auction, perhaps—they are useful too.

*B Declarations by owners*

4. Once the new assessed value notices have gone out to owners, the tax offices would invite unhappy owners to file self-assessments which would take the place of the old assessments as adjusted. The following would be obliged to declare:

*a.* All persons unwilling to accept the prior assessed value as adjusted. Self-assessment would be the only appeals procedure; it would be simple, rapid, no lawyer would be required, and neither tax officials nor judges would be involved.

*b.* All persons whose properties had not previously been assessed or who for any reason received no notice. Very small properties need not be exempt, but their owners cannot be expected to know the value. The easiest way to handle them is to tax all owners declaring that the property is worth less than—say—\$ 1,000, a round sum, such as \$ 5.00 per year.

*c.* Any owner who felt that the adjusted assessment was less than the price he would demand in the event of expropriation or of private sale.

*d.* All persons owning more than a stated total area of rural land if the land reform agency felt that detailed, current declarations would help it implement its own program.

5. A stated period would be provided—perhaps 90 days the first time and 30 days a year thereafter—for these declarations. In the first round, all non-declarers would be deemed to have acquiesced in the adjusted values. If the country's laws do not accept such presumption of acquiescence, or if alleged non-receipt of notice, etc., is grounds for escaping the consequences of the system, then *all* owners would be required to declare in the second year.

6. Those satisfied with the adjusted value would merely sign and return a copy of the notice, as prepared automatically by accounting machines, with payment of the tax. They would, of course, be required to supply other information needed for planning or control purposes, such as the names of all persons holding an interest in the property, its size, and so forth (see next paragraph). Those not assessed or dissatisfied with the adjusted value would make a new declaration which would be accepted without question, together with the tax due on the value thus declared. A fine for non-declaration within the stated time should be set at a level such that it is not too high to be enforced

39 In Bolivia in 1961, I estimated that the factor should be 30 times for price inflation alone since the last revaluation in 1953. J. Strasma, "Tax reform in Bolivia, 1961" (Report on a mission to the International Cooperation Administration), p. 21.

nor so low as not to cover the cost of sending out 'runners' to obtain declarations from substantially all owners.

7. The declaration should include, besides the value, the identity (and address to which legal notices are to be delivered) of the owner or owners and of tenants or others in possession of the property plus options outstanding, as well as all other persons with any degree of legal claim to its use, income, or value;<sup>40</sup> identification and location of the property and directions for reaching it; number of adults and children living therein;<sup>41</sup> area and class of land and buildings (even if tax-exempt) with sub-values for each;<sup>42</sup> year of acquisition and place where title papers are recorded and may be inspected.

8. The precision to be expected in this information will vary according to literacy and custom, as well as the degree to which land surveying, soil testing, etc., have been instituted. If most land could be identified precisely, with the exact area and market value, it is unlikely that assessed values (or the valuation department) would be in the bad shape typical of Latin America. Even in remote haciendas, however, it should always be possible to give directions for reaching the 'big house,' approximate boundaries, and a rough estimate of size.

9. As fast as air photos are completed (an early step both in agricultural and city planning and in longer-term tax valuation programs), owners should also be required to mark the boundaries they claim on a photo. These are then transferred to a mosaic and given a serial number which is then applied to the declaration and all other tax records. The area of the property can also be verified with a planimeter, from the photos. Completion of this process will leave the country looking like a swiss cheese, despite the classical idealizing of the land tax 'because the object of taxation cannot be hidden.'<sup>43</sup>

10. Owners whose claims overlap can be left to settle their disputes privately. When no one has claimed a parcel, however, there are several choices:

a. It may be seized for land reform. (In effect, compensation is at the value declared for taxes—zero.)

40 See footnote 38 below.

41 This information is extremely useful for land reform and city planning. Comparison with census figures also helps estimate the extent to which tax declarations are still lacking for rural and urban property in each district.

42 On the taxation of improvements, see III, C, above.

43 In the Chilean rural reassessment of 1961-64 holdings under 100 has. were declared accurately, but owners with more than 100 has. systematically 'forgot' or really underestimated their holdings, the bias increasing with true size of the holdings. It took 60 men with vehicles one year to resolve in the field some 60,000 cases of 'holes in the map,' gross underdeclaration, etc. René Parker, 'La aerofotogrametría como ayuda de un sistema tributario agrícola,' paper presented at the International Seminar on Agricultural Taxation, Santiago, 1963.

b. It may turn out to really be public land—in which case it should be duly recorded as such. Latin American experience is full of cases in which back-dated 'titles' to public land appeared mysteriously, following the building of a road or other events that made it valuable.

c. If it is under cultivation or grazing (see air photos), either the tax office or a land reform agent should visit the parcel, locate the person using it, and try to help him clear up the situation. If the owner, he must file a declaration and pay the fine. If not, he may qualify to receive title from the land reform agency.

*C Planning uses of declarations*

11. Much of the information required for planning land reform and agricultural development can be obtained in the annual declarations. In fact, with the aid of comparison with air photos (sooner or later), it should be possible to obtain much of the data now collected badly and infrequently in agricultural censuses in Latin America. Heretofore, census takers have shunned links with taxes, lest buildings, plantations, livestock and output be underdeclared. Since the overall tax value would now be set by the owner himself and not by a clerk working on the basis of the declaration, this reluctance might be lessened.

12. City property can similarly be inventoried and, with the aid of modern data processing, basic information for city planning, housing programs, and even school planning can be obtained. (Declarations included the number of rooms, area, and the number of adults and children living in each unit.)

13. Since property owners are to be clearly identified, including those with only a fractional interest, life estate, etc., it becomes possible to process the declarations for a distribution of total property holdings by size, legal form of the interest, and declared value. This makes it possible to determine how many large rural landowners have urban investments and the amount of land available for land reform, for different limits set on individual holdings.

14. Inevitably, some property will be held in the name of 'strawmen.' While this cannot be eliminated overnight, it can be greatly reduced by outlawing bearer shares and by requiring banks, trustees, and other agents to declare the true owners' name (and identification card number, accepted and universal in Latin American legal documents, however repugnant serial numbers are to most North Americans).<sup>44</sup>

15. Useful as the annual declaration is for obtaining planning data inexpensively, it should not be overloaded. Especially in the first year, the objective is to restore the

<sup>44</sup> One way to reduce the use of 'strawmen' as nominal holders of title might be to decree that real estate does belong to the person or firm in whose name it is registered and that all private contracts to the contrary shall be null and void.

property tax as an effective revenue source—and declarations should be kept as simple as possible in that first year.

*D Enforcement*

16. The declarations would be made available for public perusal in the tax offices and a summary table indicating the name or location of the property, total area, and total value declared, would be published in major newspapers. The land reform agency would be encouraged to copy the rural property declarations in whatever form it found most useful. In the interest of wide compliance, however, the taxpayer should not be asked to submit his declaration in triplicate.

17. If the property, or any portion of it, were required for public purposes, including urban renewal and agrarian reform, compensation in no case could exceed the declared value of the portion taken, plus the cost of improvements made after the last declaration. This would apply equally to land expropriated and that acquired in 'friendly' negotiations.<sup>45</sup>

18. In addition, for all properties for which no sale to the state is pending, any individual may make a written offer to buy any property which he believes worth more than the amount declared. He may offer any price he likes, except that it must not be less than 10% (for example) above the value declared or \$ 1250 for properties whose owners have declared that the value is less than \$ 1,000.<sup>46</sup> While declarations are supposed to be 100% of commercial value, the 10% 'profit' would compensate the owner for the nuisance of moving and cover the transfer tax (see 20 below).

*E Options of the owner*

19. The owner, on being notified of the offer at the address given in his declaration, must choose in writing one of three courses of action within 30 days. He may:

- a. Accept the offer;
- b. Reject it, but accept a new tax assessment at the amount rejected; or

<sup>45</sup> Ordinary expropriations of portions of properties, such as rights-of-way for roads, will be greatly facilitated by the itemized declaration of value of fields and individual buildings. Naturally, compensation in such cases might be increased above the partial tax value to reflect damage to the remainder as a unit and reduced to reflect benefit to the remainder from the public project involved, taking into account any betterment levy which may also be involved. In land reform, when the owner is allowed to retain a good-sized commercial farm for himself, no increased compensation for the effects of breaking up the larger unit is required. Reform aims to wipe out certain values of very large estates, such as monopoly in the labor market or control of water, and extra compensation would nullify the intended redistribution. It would be as absurd as compensating the rich for the effects of the progressive income tax.

<sup>46</sup> The margin may be varied to suit the reader's taste and the Finance Minister's political judgment. A more sophisticated system might permit bids for a portion of a large property, with a higher margin to cover the cost of giving easement to the part bought, or of disruption to the rest of the unit. This seems an undesirable complication for now.

c. Reject the offer, but request assessment by the tax service at his own expense. Taxes must be paid meanwhile on the amount offered and rejected, subject to prompt refund if the appraisal is lower.

20. If the offer is high, the owner may accept it (*Option a*). In this case, since the property changes hands at a price known to the tax service, that price automatically becomes the current tax value unless the new owner chooses to declare an even higher amount to forestall future offers (and fines). No fine would be levied on the former owner, but the transfer tax (typically 2 to 6%) would increase current fiscal revenue. (It should be charged entirely to the seller because the buyer has agreed to a price supposedly slightly above 'commercial value.')

The reward to the person making the offer, of course, is that he obtain the property at what he presumably deemed an attractive price. Another advantage to the government is accurate recording of the transfer price, which helps in future valuation efforts and in calculation of index adjustments in existing assessments each year.

21. If *option b* is chosen, the owner must pay the tax difference, plus a fine of double the annual tax difference, within 180 days. Alternatively, the increase could be made retroactive—but that produces problems if the tax system has been changed or the property has changed hands during the last three years. Some penalty is vital, however, to ensure reasonable initial declarations by the majority of owners. If taxes were to rise only for the future, all owners would naturally declare low until an offer obliged them to accept an honest valuation. Since the number of persons who know the real estate market well is limited, as is their capital, the more owners who declare full values at the start, the faster the rest will be brought into line by offers.<sup>47</sup>

22. The frustrated buyer, in effect, has helped make an appraisal which the tax agency would probably have not been able to make under traditional systems in underdeveloped countries. He should be compensated with a share of the increased taxes and fine when he is unable to buy the property because the owner invokes *option b or c*. Suppose, for instance, that a property had been declared at \$ 5,000 and someone bid \$ 15,000, which the owner considered still below market value. If the owner chose *option b*, the valuation would be increased. If the rate were 15 per mil, for example, the \$ 10,000 valuation increase would mean an extra \$ 150 a year in taxes, plus a fine of \$ 300.<sup>48</sup> The individual who made the offer could well be given 50% (or \$ 225) for his trouble.<sup>49</sup>

23. When the owner does not wish to sell at the price bid, yet thinks that his property is not worth that much on the market and so refuses to pay taxes on that basis, he can

47 Also, so long as they are underassessed and fear an offer, owners will pressure and demonstrate, seeking the repeal of the enforcement system. Once they have accepted full-value assessment, the owners properly turn their political activity toward the rate, rather than the enforcement mechanism.

48 Note that this system is independent of the rate structure. It determines values; rates may be proportional, progressive, or even a mixture of exemptions and rates varying by land use or total holdings.

49 Payment should be prompt and not depend on whether the owner is prompt or tardy in paying the tax arrears and fine. Collection of taxes, as opposed to assessment, is not the task of the bidder.

SELF-ASSESSMENT FOR REAL ESTATE TAXES

request the tax service to determine the market value at his expense (*option c*). Pending that determination, which may take several years if the appraisers are few and many owners request the service, he must pay taxes on the amount offered. Once the appraisal is made, he must also pay the fine, less the charge for appraisal, less (or plus) the tax difference between the value of appraisal and the amount refused. The bidder receives his share once the tax value is finally set, with interest at the government bond rate.

24. The owner may make the same request, without even waiting for an offer, if he objects to the adjusted old assessment or knows that he does not want to sell at any price. If he makes the request (paying the fee in advance) at the start of the new system, he can also avoid any penalty, because he will not declare at all under it. He pays taxes meanwhile on the adjusted old assessment or for new buildings on the cost of construction, properly documented. However, the cost of appraisal may well come to as much as a full year's taxes, depending on tax rates and the type and location of the property.<sup>50</sup>

25. When the owner requests official valuation, the tax service retains a professional appraiser (or sends one of its own staff). The figure set by the appraiser will then be accepted by the service as the definitive assessment for, say, five years (subject to overall adjustments for inflation, applied to all property), and no private offers will be accepted during that period. Should the property change hands at a higher price, the assessment should be raised. Lower transfer price reports would be ignored, however, to avoid increased temptation to fraudulent reports.

26. Since the appraisers are human, it would be difficult to force owners to accept the result with no possibility of appeal. They would therefore always be permitted to return to the self-assessment system (and its consequences). Likewise, either owners or the tax service could request a second appraisal by a different valuer, at the expense of the party making the request, the resulting figure to be averaged with the first appraisal. The great advantage of the self-assessment system continues to be its removal of assessments from the courts without leaving taxpayers with no recourse from tax officials' administrative determinations.

27. When owners request appraisal after an offer is made (*option c*), the fine and reward depend on the outcome. If the appraisal figure is not more than, say, 20% above the

<sup>50</sup> Agricultural appraisal requires soil maps, irrigation studies, etc. These should be made by the Ministry of Agriculture rather than charged to owners if they have been made in other regions without charge to landowners. Still, the cost of appraisal should be set high enough to discourage massive use of this option at the start. In California, appraisal of scattered farms takes about three days a piece (letter from Ronald B. Welch, Assistant Executive Secretary, Property Taxes, California State Board of Equalization). In Peru the typical time required would be a week (conversation with Ing Hugo Vega, member of the Cuerpo Técnico de Tasaciones, a society of professional appraisers). Houses, of course, are easier and from one to eight per day can be done, depending on how close together they are (letter from Welch).

value declared by the owner, no fine would be levied.<sup>51</sup> Reward would be paid only on the amount by which the appraisal figure exceeded the original declared value—just as when *option b* is invoked. However, in this case the actual amount bid becomes irrelevant. Comparison of such bids with subsequent appraisals may give a useful idea of the level of bids in general, however.

28. If an owner, duly notified as in other legal processes, makes no response within the 30-day period, he shall be deemed to have exercised *option b* and the tax service will bill him accordingly, creating a lien on the property for the increased taxes and fine with the full force of all other tax assessments.

*π Inflation*

29. If there is a significant inflationary trend in the economy, valuations—no matter how determined—will shortly be obsolete.<sup>52</sup> It is necessary to adjust them automatically from year to year and the most practical method is to raise them according to the change in an index of prices to consumers, or wholesale prices, or perhaps of building costs. An index of real estate prices may become possible when transactions following the choice of *option a* (to sell) provide a source of honest transfer prices. While any index will be imperfect, adjustment will be more just than allowing property taxes to remain frozen while salaries and retail prices (and the taxes levied on them) rise.

30. Any owner who feels that the taxable value of his property as adjusted by an index is out of line may declare a new value under the market-enforced self-assessment system; there is thus a simple, permanent appeal system in which the appellant's figure is always accepted.

31. Should a currency devaluation of 10.0% or more occur between the deadline for declarations and the deadline for presenting bids in any quarter, that 'round' shall be suspended and bids returned. Owners who feel that the index adjustment in succeeding months does not reflect property value accurately may, of course, file a new declaration prior to the closing date for the next regular bidding period.

32. Offers and appraisals will be made as of the closing date for declarations each year. Actual transfers resulting from *option a* will be payable at those prices adjusted by actual increase in the Consumer Price Index through the month just prior to actual payment for the property; the transfer tax will also be calculated on this adjusted amount.<sup>53</sup>

51 If it were no higher than the previous declared value, it would seem unfair even to have charged for the assessment. I would suggest refunding any sum by which the new assessment failed to exceed the sum of the old valuation and the charge made for the assessment, up to a full refund. The state share of fines on other cases would finance the refunds, since the appraiser should receive his fee in any case.

52 It should be noted that not all Latin American countries suffer from inflation in any given year and these adjustments might not be needed at all in some of them.

53 Delinquent taxes should also be adjusted for inflation since the due date. If this is not done, inflation gives taxpayers every incentive to delay payment until the property is about to be auctioned.

G *Disclosure laws*

33. Existing laws prohibiting the disclosure of tax declarations to third parties will have to be repealed. Although supposedly designed to protect the privacy of individuals and encourage fuller declaration of income from dubious sources, this provision fails because the shady taxpayer knows that the tax authorities are not as efficient as the police. If the police have not detected his activities, the tax agency won't.

34. In practice, secrecy serves to protect the dishonest from publicity and to punish employees (or newspapers) that dare expose declared values which the public will know are false.<sup>54</sup> The failure of rewards for informers to elicit much useful information in Latin America arises from delays in payment, possible reprisals, and especially from the fact that people who would know whether declarations were false have no legal way to learn the amounts declared.

H *Some procedural safeguards*

35. To ensure that offers are bona fide, each should be accompanied by a bank guarantee, bonds, money order, or cash for (say) 5% of the amount bid.<sup>55</sup> If the owner accepts the offer (*option a*), but the person who made it fails to appear or to complete the transaction within (say) 90 days, the deposit is forfeited. The owner receives 80% of it for the nuisance caused him and the assessment remains where it was.

36. The 20% of the deposit that goes to the state covers costs of notification and also prevents owners from bidding very high prices for their own properties, through an agent, and of course, failing to carry through any transaction—keeping actual tax assessments low at no cost to themselves.

37. For farm land, transfers normally occur after the harvest, so the time limit for transfer would be 60 days after the end of the agricultural year in the area, if the previous owner so requested when choosing option a.<sup>56</sup>

Improvements made after the date of the tax declaration and increased value of trees or plantations would be valued by mutually-agreed-upon appraisers or, in their absence,

54 As I understand existing Chilean law, the punishment given a tax service employee who divulged information about income tax declarations could easily be more severe than the punishment of a tax evader who was turned in as a result of public knowledge of the amounts declared. Thus have the legislators helped evaders protect themselves!

55 Since the nuisance to the owner and the disincentive to new investment in land will be considerable even if an offer is not bona fide, one would prefer a larger guarantee deposit. However, in many poor countries the banks are controlled by landowners. They will hardly lend or provide guarantees for this purpose, so the deposit has to be kept low so that real estate brokers, lawyers, and other middlewealth individuals can make bids on the strength of their own capital.

56 Likewise, where an owner or tenant with an unexpired lease showed that relocation would cause undue hardship for reasons of health, the courts could grant up to three successive 60-day extensions for possession of the property. Neither in this case nor in the 'crop year' extension could the previous owner change to option b after the end of the 30-day decision period.

by a court. (Hence the need for itemized declaration of existing improvements, even if tax-exempt.) Tenants might be protected by allowing them to match the price to be paid (see paragraph below); the bidder in such a case should at least receive a consolation payment of the first year's tax increase and the land reform agency should reimburse his expenses.

38. If the transfer cannot be completed within the time limit because the title is not clear, or because the owner refuses to deliver the property, the person making the offer which was accepted need only deposit the balance of the cash down payment with the appropriate court, which will order effective possession for the buyer.<sup>57</sup> The former owner, however, will receive no money unless he clears and transfers the title within a stated time.<sup>58</sup> Should he be unable to do so, the court will issue a new and unchallengeable title. The money will remain on deposit for the period prescribed by law, as definitive indemnity to all persons who, within the prescription period, might subsequently prove that they had had valid title(s) to the land. (If titles are generally cloudy, special courts or laws may be needed to improve the definition of property rights— but that is outside the scope of this paper.) Note that the tax office itself is in no way involved either in transfer or in title and boundary disputes.

39. To avoid continuous bother for owners and the tax service, offers would be received only during the first week of each calendar quarter; there would thus be four 'rounds' of tax value tightening each year.<sup>59</sup>

40. Transfers, rentals, issuance of options, or other changes in ownership and rights in the property must be declared in the local tax office, where they will be displayed for the information of prospective bidders. Non-declaration shall make such rights or transfer null and void should a tax offer be made, and any parties injured thereby must look for damages to the person named as owner in tax records as of the date of the offer. No changes will be received, nor take effect, during the week of reception of offers or thereafter, until any offer is disposed of.

41. To discourage corruption of the process, offers would be made on printed forms, folded and sealed to conceal from tax office employees the identity of the property involved and the amount of the offer made. The person bringing in the offer would receive

57 Should the actual area be less than that declared, the courts would decide an appropriate price reduction. If greater, indicating possible tax evasion, the price would not be increased. For rules as to the cash down payment and period for settlement of the balance, see numbers 61-66.

58 Should any person with an interest in the land not have received notices, etc., because his interest was not declared by the owner/occupier who filed the declaration, the law should protect the title of the new owner by limiting the actions of the injured party to suit against the ex-owner who failed to report that interest.

59 In countries with rapid inflation, the offers and deposit should be made in terms of money of the month of the tax declaration, with actual payment of the balance to be made in the same purchasing power, whenever actually made to the owner or to a court.

SELF-ASSESSMENT FOR REAL ESTATE TAXES

a signed receipt bearing a serial number identical to that on the outside of the offer form. The clerk would certify the amount and form of the guarantee presented in the same receipt and on the outside of the offer itself.

42. After the deadline for presenting offers, these would be opened and examined.<sup>60</sup> Those for which the guarantee was insufficient for the amount bid, would be set aside. All others would be sorted according to the property involved, and all but the highest offer for each property would be set aside. The amount of the successful offer would be noted on each of the unsuccessful ones, and the unsuccessful bidders would be entitled to information as to the option subsequently exercised by the owner. (This is further to hamper corruption and to improve knowledge of the market by those bidding in it.)

43. The highest offer would then be communicated to the owner; the rest would be returned (with the guarantees) to those presenting the numbered receipts.

44. While owners would normally be welcome to raise declared values at any time, 'amended' declarations would not be accepted during the week before the offer period, not during the offer period itself, including the delay until owners had been notified. An owner whose property had attracted an offer could not file a new declaration at all, but must choose one of the three options.<sup>61</sup>

45. On the first day of the week before the offer period, notice would be posted in the tax offices identifying the properties for which amended declarations, transfers, leases or options had been presented after the initial declaration. Prospective bidders would be entitled to the details so that their bids would reflect current status of the property.

46. An offer once presented could not be withdrawn without forfeiting the deposit in favor of the state if the offer had not yet been relayed to the owner, or of the owner and the state if it had.<sup>62</sup>

47. To avoid intimidation of possible bidders and vengeance on those who do make bids, offers should be anonymous. The guarantee could be posted in bearer bonds, bank drafts, or cash. The numbered receipt, which in effect would be freely transferable, would identify a person entitled to buy a property or if the offer were rejected, to recover the guarantee and collect any reward.

48. However, if agrarian reform laws limit landholdings of any person or family, or of foreigners, no land could be bought by or for persons for whom the property involved

<sup>60</sup> This procedure seeks to prevent private 'leaks' by tax service employees to owners or to prospective bidders, as to the amounts bid or even to the fact that an offer has been made for specific properties. The numbered receipts and notation of data right on the offer aims to prevent the 'mislaying' of offers and other sabotage efforts through landowner bribery in the tax office.

<sup>61</sup> See paragraph 19 above.

<sup>62</sup> See paragraphs 35 and 36 above.

would exceed the legal limit; this control should be exercised by the registrar of deeds who formalizes land transfers, rather than by the tax agency.

49. Since it would be hard to evaluate large rural properties from public roads, if any, owners would be obliged to permit free entry during daylight hours, limited to roads, canals, fencelines, etc., during the week following publication of declared values. Visitors would not be permitted to enter buildings, nor to approach closer than, say, 50 meters to the owner's dwelling. This would, of course, only be necessary for properties so large that they cannot be inspected otherwise—the very properties most frequently the concern of land reform, tax reform, and agricultural development programs. Another approach would be to require permanent easement for the public along roads of properties housing more than, say, 25 persons. Private enclaves and company towns, separated from the rest of the country by armed guards and 'No entry' signs are seldom compatible with national integration, a frequent goal of the underdeveloped countries.

50. The tax office reserves the right, of course, to proceed on a cadastral survey, as well as to assess specific properties or all property. This power would be used in cases or areas when market-enforced self-assessment does not seem to be working; it is the only definitive way to cope with evasion through over-valuation of exempt improvements. For these assessments, appeal would be to the courts.

#### 1 *Getting started*

51. To ease the installation of the new system, ample information about its working should be spread to the community. It may be best to indicate zones or types of property where it should be introduced first, proceeding gradually to the whole country. Only those unwilling to accept the old assessment as arbitrarily adjusted, plus those never before assessed, would be subject to offers in the first year (see paragraph 4 above). Yet it must be remembered that until the day when they are obliged to accept fullvalue assessments, property owners will try to repeal the system—piecemeal introduction may thus be more vulnerable and less effective than nationwide reform at once.

52. Persons judged so worthy or so politically powerful that they must be excluded from market enforcement should have their properties valued by the index adjustment without appeal or being subject to offers, provided land use had not changed. This would usually include land reform beneficiaries, for whom the reform agency would set the tax assessment together with the price for the land they receive.<sup>63</sup> It would also apply to low-cost public or private subsidized low-income housing whose tax valuation would be based on the cost as determined by the public agency involved.

<sup>63</sup> Reform governments should resist the temptation to exempt land reform beneficiaries from land taxes. Taxes prevent lapse into pure subsistence farming and ensure future contribution by the sector to general revenue, even after reform is completed. If they are exempted initially, taxpayer strikes, as in France, will frustrate future efforts to tax small holders.

53. Owners of complex properties, such as city department stores and factories, would doubtless choose professional assessment from the start (see paragraph 24 above). New factories receiving tax incentives might well receive courtesy appraisal without the usual charge and with or without their own declaration as a starting point. The tax agency will still need a staff of professional assessors, highly skilled, even after the new system is well installed, for requested appraisals, inheritance tax valuations, etc.

#### J Corporations

54. Corporation landowners would pose no problem to this system. The tax base is the real estate held by the corporation, not the corporation itself. When someone considers that realty undervalued, he bids for it, without thereby assuming any responsibility for other assets, liabilities or activities of the corporation. The same applies to cooperatives and other forms of multiple ownership.

55. The tax assessment policy here proposed is independent of the rate structure. However, if that structure includes progressive rates to discourage holdings in excess of certain limits, or if land reform legislation prohibits holdings above such limits, bearer shares in landowning corporations must be prohibited and the tax declaration must include the list of shareholders and the number of shares owned by each.

56. Prohibition of bearer shares for corporations of all kinds would greatly facilitate enforcement of all taxes and especially those on income and inheritance.<sup>64</sup> The only real use of bearer shares in Latin America today is tax evasion, so no self-respecting government should tolerate them. The so-called 'substitute' annual taxes (as used in Argentina and Uruguay) of 1% or so on capital are no real substitute for the inheritance tax. They are largely shifted to consumers and workers as a cost, and they nullify the progression purportedly built into the inheritance tax rate tables.<sup>65</sup>

#### K Very large units

57. When one taxpayer owns a great deal of land, separate declaration should be required for each operating unit. Even so, some operating units (especially livestock operations) will be so large that few persons will have the capital to make an offer. Those who do are likely to feel a sense of solidarity with the landowners and will not make offers. Again, if the banks are controlled by the wealthy, they will not finance the deposit—let alone the purchase—of land by a tax bidder.

64 Uruguay recently went further; instead of eliminating bearer shares in landholding corporations, now common, corporation ownership of agricultural land was outlawed entirely by law 13318 of Dec. 28, 1964, Art. 213-216. All land must be held only by natural persons and title registered in the name of the true owner or owners within two years.

65 See J. Strasma, 'La tributación del capital y el desarrollo económico' (Santiago: Instituto de Economía, 1963), chapter 3.

58. However, it is precisely the largest units, not the small or medium ones, that are of greatest interest to land reform agencies. Enforcement of reasonable tax valuations of these largest properties requires the existence of a land reform agency, with a will and resources adequate to represent a genuine threat of purchase.

59. In many countries such a land reform agency does not exist, or is ineffective, often for the same reason that tax assessments are far below market values. As a stopgap, then, owners of units over a certain value, once adjusted by the index, should *not* be permitted to appeal by declaring lower values subject to bids that the owners know will not be forthcoming. Rather, owners of all properties assessed over a given figure, say, \$ 100,000 after index adjustment, could appeal only by *option c*.

60. Naturally, owners would still be obliged to submit *higher* values than the index-adjusted figures, if they are unwilling to settle for those figures in the event of expropriation. Failure to so declare would constitute ratification of the index-adjusted value as a ceiling for compensation in that (unlikely) event.

L *Payment terms for option a transfers*

61. The mode of payment required of the buyer (if the owner chooses *option a*) should depend on the use and value of the property. A house or farm occupied by its owner and bought at less than, say, \$ 12,000 should be paid for in cash except that the buyer would assume any existing mortgages if he wished.

62. Mortgage lenders, normally sympathetic with owners of large properties, might try to sabotage the process. All mortgage lenders would therefore be obliged to accept the substitution of debtors unless they could satisfy the Superintendent of Banks and Credit that the property value did not really cover the unpaid balance. Since this would imply that they had made an imprudent loan in the first place, few banks would dare make such claims. Other lenders would likewise hesitate to allow the Superintendent to probe into their (now uncontrolled) lending practices.

63. Rental dwellings, commercial buildings, industrial plants, and houses and farm properties over the limit set would be treated according to the terms on which such properties are regularly sold by willing sellers to normal buyers. This would usually mean that existing debt would be assumed, a certain fraction (perhaps 10%) of the total price be paid at the time of transfer and the balance be paid in notes due over, say, 3 years, with a second lien on the property to guarantee payment. Again, lenders would be obliged to show cause for refusal to accept substitution of borrowers for any existing mortgages.

M *Land reform transfers*

64. If a land reform agency bids for the land, then the owner has *no* option. He must transfer title and he must accept payment in bonds on the same terms as those applied to expropriations for land reform purposes. However, he at least receives the full amount

he declared for tax purposes. If the land had been expropriated, it would have been subject to appraisal. He could not have received more and he might possibly have received less than his declared value."<sup>66</sup>

65. To encourage 'spontaneous' land reform, tenants could be permitted to buy the land they till at the tax value declared by the owner at any time, paying only the current year's legal rental down and the balance in bonds obtained from the land reform agency.

66. If the agency is proceeding by zones or is overworked, reform could be speeded by allowing groups of persons eligible for reform parcels to choose a property and submit a plan of division or of cooperative operation to the reform agency. If the plan met minimum standards laid down by the agency, it would bid or would provide land bonds to the interested parties so that they could acquire even very large properties with minimum effort by the reform agency itself. However, they would have to pay the value declared. If that value was inflated by prestige considerations, monopoly power over a captive labor force, etc., it might be a little cheaper to wait for the reform agency to expropriate.

#### V. CONCLUSIONS

This paper suggests measures with which a Finance Minister who so wills and who has the political backing, can effectively raise property tax assessments and complete the job during his own 'political lifetime.' Private property, itself a creation of the state, is taxed and logically should be valued by the state. The present proposal does not change the state's responsibility of control. What it does do is enlist voluntary cooperation for a prospective reward just as every country does in enforcing the income tax.

##### A *The effective tax increase*

The first step is an index adjustment of all existing assessments aimed to put the average property at or above market values. This will separate the inevitable opposition to higher taxes from the legitimate discussion of the most practical and just way to assess those taxes. A rate increase won't do because it confuses issues and perpetuates under-assessment, hampering the operation of other taxes related to property values (e.g., income and inheritance taxes).

##### B *Appeal by self-assessment*

The second step is to escape the enormous burden of traditional appeals, replacing recourse to the courts with permission for owners unhappy with the index-adjusted values to substitute their own valuations. Owners of properties not previously assessed at all would also be required to declare the value. Owners would hesitate to understate

<sup>66</sup> In expropriation, the law might allow the owner to retain part of the land. When the reform agency used the method here suggested, that would not necessarily apply—unless the agency allowed him to request a parcel, together with other candidates.

market values more than 20% or so because any person or company could make a bid for self-assessed property at 10% or more than the value declared. If the owners declined to sell, the tax value would be raised to the amount rejected and a fine would be levied, to be shared with the frustrated bidder.

In a third stage, *all* assessed values would be published and subject to bids. Owners whose properties were still under-assessed even after the index-adjustment would thus be brought into line; previously only those who thought their property over-assessed were involved.

#### *c Appeal by appraisal*

All assessments, declarations, and offers would be subject to automatic adjustment should inflation exceed certain rates per year or month, or in cases of sudden devaluation.

Owners unwilling to be subjected to this procedure could request fiscal assessment, but would be obliged to pay the full cost thereof to the tax service. The charge would be high enough that the service could obtain appraisers whose desire to continue receiving such fees (from the tax service) would offset the temptation to accept bribes from owners. At the very least, corruption should be much less than at present, when appraisers are usually overworked and are paid salaries so low that they feel obliged to accept 'gratuities' from property owners.

Appraisals set would be reviewed by the tax service which could reject the first one and assign a second appraiser (at its own expense). The owner, if dissatisfied with the first appraisal, could likewise request a second valuation—at his expense. In either of these cases, the two values would be averaged for the tax valuation. The tax service would have no further appeal; the owner could only appeal by submitting his own value and returning to the market-enforced system.

#### *d Reassessment and land reform*

The net result would be a great relief of court calendars and of the tax services. Appraisers and lawyers now working for owners would lose a lucrative practice whose social value in underdeveloped countries has sometimes been questionable. Both, however, would have socially-useful employment in land reform programs and urban renewal, in acquisitions and in clearing up titles for small holders. Some will also continue to earn handsomely—by making bids for undervalued property in the new system.

Market-enforced self-assessment will not solve every problem associated with taxation and public administration. Corruption can be greatly reduced through procedures here suggested, though including these details here may make the system appear more complicated than it really is. Those who dislike private profits from enforcement of taxes should consider whether they should not dislike even more the present profits made by evaders of property taxes government is unable to assess under older systems.

In the longer run, technical assistance and training programs (financed with part of the higher property tax revenues) would permit a cadastral survey. Such assistance would make possible the organization of the technically-competent, responsible valuation department and land use planning agency that are essential to modern public administration.

## SELF-ASSESSMENT FOR REAL ESTATE TAXES

The measures here suggested are intended for use right now, with the staff, the quality of public administration, and the character of taxpayers as they now are, in underdeveloped countries. They are not a valid substitute for land reform.<sup>67</sup>

At times the political situation permits enactment and implementation of either tax reform or land reform, but not both at once. In such cases—Ecuador, Peru, and Chile in 1964-65 may possibly be examples—land reform should come first, in my judgment. It breaks drastically with custom and with a power structure, and this will subsequently make it easier to apply the tax reform here described. In addition, since the principle of compensation at tax values is fairly well established,<sup>68</sup> the very eve of land reform is not a logical moment for government to allow owners to raise tax values!

In many underdeveloped countries, however, the land reform movement has not yet achieved the strength needed to bring about reform—by violence or at the polls. Yet in some of those countries, and in others such as Mexico, Bolivia, and Venezuela where reform is largely completed, there may, at times, be the lesser strength needed to enact a tax reassessment. Traditional methods have often failed or delayed many years in bringing this about.

### *E One final problem: a practical test*

The proposals made here appear to offer a chance to achieve effective property tax reassessment during the political life of a cabinet or a finance minister. The next step is in the hand of the reader: to arrange a test application in a country, province, state, or municipality that genuinely wants reassessment. And if at first the idea is rejected indignantly, public discussion may at least force governments to decide whether they *want* to reassess. If this paper does nothing more than stimulate more effective work by traditional methods by tax officials trying to show that the new technique is not needed, that too will be a contribution.

67 Land redistribution is painful to a few large landowners, but its potential beneficiaries are numerous and can often be organized to demonstrate for land reform or to defend reform governments. Property tax increases, on the other hand, affect thousands of small holders, urban as well as rural, while no one perceives any very direct benefit. Sophisticated landlords therefore often argue for tax increases as more 'objective' or 'impersonal' than land redistribution. While tax measures could, in time, attain many of the objectives of land reform, landowners advocating tax reform usually merely hope thereby to escape any reform at all.

68 See United Nations, *Fourth Report On Progress in Land Reform* (New York, 1965), chapter 3.