# LOCAL GOVERNMENT

# VIABILITY:

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## TAXATION

Local Government Viability: An analysis of Municipal Tax Sources in South Africa and the application of international trends to broaden the tax base.

WYNAND P. STEYN

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Local Government Viability: An analysis of Municipal Tax Sources in South Africa and the application of international trends to broaden the tax base.

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# UITTREKSEL

## DIE ANALISERING VAN MUNISIPALE BELASTING BRONNE IN SUID AFRIKA EN DIE TOEPASSING VAN INTERNASIONALE TENDENSE TEN EINDE DIE BELASTING BASIS TE VERBREED

Plaaslike owerheids finansies in Suid Afrika verkeer tans onder groot druk weens verwagtinge vanaf die sentrale regering en kiesers. Hierdie verwagtinge word grootliks geskep deur politisie wat beter infrastruktuur belowe gedurende verkiesings veldtogte. Andersyds is die sentrale en provinsiale regerings besig om meer en meer funksies af te wentel na plaaslike owerheids vlak. Die bevondsing van hierdie funksies deur sentrale en provinsiale regerings hou egter nie tred met die toepaslike groeikoers en verantwoordelikhede van hierdie funksies nie. Dus laat dit 'n tekort, wat deur die plaaslike owerheid gefinansier moet word.

Die druk op plaaslike owerhede om infrastruktuur en dienste te voorsien oorskry die beskikbaarheid van fondse. Plaaslike owerhede staan dus voor 'n paar keuses. Eerstens kan belasting en ander tariewe verhoog word tot 'n vlak waar inkomste en uitgawe vlakke balanseer. 'n Groot knelpunt in hierdie metode is bekostigbaarheid vir alle inwoners. Sodra die tarief vlakke die kunsmatige weerstandspunt bereik sal die inwoners of weier om te betaal, of geografies verskuif na 'n area waar tariewe meer bekostigbaar is.

Tweedens, alternatiewe bronne van inkomste kan ondersoek en geimplimenteer word. Daar is verskeie voorbeelde van soortgelyke bronne in die internasionale plaaslike owerheids sfeer. Een so 'n voorbeeld is die gebruik van indirekte

belasting. Die belasting word op 'n ander punt gehef, tiperend op 'n kommersiële onderneming, en dan afgewentel na die eind verbruiker van die goedere of diens. Die voordeel hiervan is dat al die inwoners deel van die belasting las dra en nie net die eienaars nie.

As deel van die verbetering in inkomste potensiaal, vir plaaslike owerheidsbelasting, moet daar ook seker gemaak word dat die basis waarop die belasting bereken word tred hou met plaaslike mark toestande. Dit kan bereik word deur die gereelde (jaarlikse) waardasie van alle eiendom binne die plaaslike owerheid se gebied van jurisdiksie. Verskeie metodes kan gevolg word sonder dat die koste die potensiële inkomste aanwins oorskry.

Huidige wetgewing is egter oormatig voorskriftelik en wysigings is nodig om die diskressie en outonomiteit van plaaslike owerhede te verseker. Een goeie voorbeeld hiervan is die vrystelling van die eerste R 15,000 van waardasie van eiendoms belasting. Die artikel in die wetgewing is bepaald regressief wanneer dit kom by klein plaaslike owerhede. As norm is die gemiddelde waardasie in 'n klein plaaslike owerheid veels laer as in 'n groot plaaslike owerheid. Dit bring dus mee dat die klein plaaslike owerheid 'n groter gedeelte van sy belasting inkomste prys gee, deur 'n belasting vrystelling waaroor hy nie beheer het nie. In hierdie geval behoort die wetgewing gewysig te word sodat daar van 'n persentasie van waardasie gebruik gemaak kan word. Daardeur sal klein en groot plaaslike owerhede, in verhouding, dieselfde geraak word.

'n Aantal wysigings in wetgewing is aangedui en die toepassing daarvan uiteengesit in 'n finansiële model. Die model toon die effek van die individuele wysigings op die potensiele belasting inkomste van die plaaslike owerheid. Die model versterk verder ook die bevindings dat wysigings aan die huidige wetgewing nodig is om die langtermyn finansiële oorlewing van plaaslike owerhede te verseker.

Derdens, begrotings beheer en prioritisering. Alternatiewe metodes moet gevolg word tydens die voorbereiding van begrotings. Daar behoort van die standpunt af uitgegaan te word, dat die nuwe finansiële jaar geen addisionele inkomste sal oplewer bo die van die vorige jaar nie. Verder behoort die verkose verteenwoordigers die departementshoofde met realistiese doelwitte te voorsien aan die begin van die begrotings proses. Die departementshoofde moet nie net die finansiële inligting aangaande die huidige vlakke van dienste in die begroting voorsien nie, maar ook alternatiewe vlakke van dienste om oor te besin. Hierdie alternatiewe moet alle koste, kort en lang termyn, insluit. Ander relevante inligting soos sosiale en gesondheids effekte wat die alternatief tot gevolg sal hê moet duidelik uitgespel word. Slegs met al hierdie inligting beskikbaar, kan daar van die raadslede verwag word om die harde besluite te neem wat nodig is om begrotings prioritisering effektief toe te pas.

Gedurende die studie is ook bevind dat daar 'n wesenlike kommunikasie en opleidings gebrek bestaan tussen die plaaslike owerheid, die media en inwoners. Meer aandag en hulpbronne moet aan hierdie aspek bestee word. Dit is nodig om die breë publiek in te lig en te skool jeens die werkinge van plaaslike owerhede. Op die lange duur sal die publiek meer begrip toon wanneer hulle versoeke en verwagtinge gedurende begrotings prioritisering afgewys word, of die plaaslike owerheid genoodsaak word om tariewe te verhoog.

# SUMMARY

# THE ANALYSIS OF MUNICIPAL TAX SOURCES IN SOUTH AFRICA AND THE APPLICATION OF INTERNATIONAL TRENDS TO BROADEN THE TAX BASE.

Local government finance in South Africa is experiencing extreme financial pressure due to the expectations of both politicians and the voter core. The politicians who, in their election campaigns, promised the voters better infrastructure mainly created these expectations. Central and Provincial government added to this pressure with the devolution of functions to local government level. The financial resources transferred by central and provincial government to local government for these additional functions, however, have not kept pace with the responsibilities. This is leaving a shortfall that must be financed by local government from their own resources.

The pressure to improve and provide new infrastructure and services far exceeds the availability of funds. Local government has three alternatives to provide the needed funding. First it can increase its rates and taxes to a level where revenue and expenditure come to equilibrium. The problem with this alternative is affordability. Taxes can only be raised to a certain level before formal resistance from ratepayers will result in refusals to pay or they would geographically move to an area where taxes are more affordable.

Second, local government can investigate and implement alternative revenue resources. A number of such alternative sources were found during this study of international trends. One example is indirect tax, which is raised at one point and then devolved downward to the end user of the goods or service. The advantage

is that both the owners of property as well as all other inhabitants of the area carry the tax burden.

At the same time, local government must ensure that the base (property values) on which these taxes are calculated stay current in relation to market trends. This can be achieved by ensuring that revaluations take place on a yearly basis for all properties. There are various methods, such as the relative sales approach, that local government can use in this process to counter the prohibitive costs of a yearly zero based evaluation.

Current legislation in South Africa is over prescriptive and amendments are needed to ensure local authorities maintain their autonomy and discretion over their own affairs. One example of such prescriptiveness is the exemption of the first R 15,000 of the valuation of residential property value. This section in the Act is certainly regressive as far as small local authorities are concerned. Valuations in small local authorities, as a norm, are much lower than that of their larger counterparts. The result is that they, the small local authorities, lose a larger proportion of their tax revenue due to this exemption. Legislation needs to be amended to allow for a percentage of valuation as exemption. This will ensure that both large and small local authorities carry a relatively equal loss in revenue.

The study proposes a number of amendments to legislation currently in place and through the financial model show the effect of such amendments on property tax revenue. The model further strengthens the findings that legislation amendments are needed to ensure the long-term viability of local government in South Africa.

Third, local government cannot only rely on additional revenue resources to resolve the dilemma. Budget prioritisation and control is of great importance. Alternative methods and procedures for budget preparation must be developed and implemented. Sufficient information must be given to Council to enable them to make hard budget decisions and to later defend those decisions with their voters. The information should include the long-term socio-economic effects of alternatives to the proposed budget items. Multi year budgets showing the long term financial effect of a project is an absolute must.

During the study the need for proper communication also came to the fore. There is a lack of effective and open communication between council, the media and the ratepayers. More resources should be channelled to this important aspect of local government. It is necessary to inform and school the broad public on the responsibilities and operations of local government. Properly informed, the public will over the longer term show more understanding when projects are deferred or tax levels are raised.

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# CHAPTER ONE

# NATURE AND SCOPE OF THE STUDY

## 1.1 Introduction

Over the decades local government in South Africa has experienced many changes. Local authorities were reasonably financially autonomous until the mid 1980's when the South African government and freedom movements started utilising municipalities as a political weapon. Through boycott actions and a drastic cutback in government subsidies, the predominantly black local authorities were economically destroyed while the predominantly white local authorities remained stable.

During early 1994 the South African government adopted legislation, which forced previously separate black and white local authorities to amalgamate. Councillors were appointed according to the terms of amalgamation agreements. In 1995 and 1996 councillors were elected on a quota system. According to the White Paper on Local Government (SA, 1998:12) this transition has resulted in a local government system consisting of 843 local authorities with over 11 000 democratically elected councillors. Approximately one third of these local authorities faced serious financial difficulties or administrative problems.

Further amalgamations were enforced by the central government during the year 2000. This was done through the Demarcation Board (Local Government Municipal Demarcation Act, Act No. 27 of 1998). These amalgamations broadened the area of jurisdiction of the already cash strapped local government in South Africa.

## 1.2 Background To This Study

Property tax has historically been associated with local government in most countries. One reason that taxes on land and property have been considered especially appropriate as a revenue source is that real property is immovable - it is unable to shift location in response to tax. (Bird and Slack, 2004). This is certainly also true of local government in South Africa.

Historically, in urban South Africa, local government revenue was mainly self-generated through property taxes and the delivery of services to residents and businesses. A smaller portion of local government income was derived from central government subsidies. During the amalgamation process, instituted by the central government, these subsidies were substantially increased, only to be reduced shortly thereafter. The reduction left local government with only property tax and income from municipal services with which to finance an increased demand for infrastructure and services.

Local government, notwithstanding its reduced revenue, is expected to fulfil its roles of providing good governance and developing infrastructure in the previously disadvantaged sections of the community. This created the dilemma, that the demands to spend on infrastructure far exceeded the capacity of local government to fund the projects from revenue.

The problem of having to spend more than can be paid out of revenue is further aggravated by political pressure to provide free or subsidised basic services to the economically disadvantaged. A balance needs to be found between what the politicians' want to spend and what local government can afford from its revenue base. A balancing act that would need innovative measures in finding additional sources of revenue and the prioritisation of expenditures.

This study will mainly deal with the income generated from municipal taxation, which includes property tax as the largest source of income. Revenue from services such as electricity, water, refuse removal and sewage purification is excluded as these services are run on either a commercial or economic basis. In other words, these services pay for themselves through user fees. The purpose of this study is to find additional sources of income through reasonable taxation, not only of property owners, but also of corporate institutions to broaden the tax base for local government. In addition to this, attention will also be given to the prioritisation of expenditures to relieve pressure on scarce revenue sources.

## 1.3 Problem Formulation

The vast increase in the responsibilities of local authorities without a concurrent increase in the income base has placed a severe strain on the finances of local authorities. Add to this dilemma voter expectancies such as the demand for houses, improved infrastructure and relief measures for the poor. Politicians, during the election process, created all these additional pressures on local government. One can then clearly see that the income base of local government, as it stands now, is not sufficient to cover the expected expenditure.

Over the past ten years local government finances in South Africa came under great financial stress due to changing legislation. The amalgamation of previously disadvantaged areas into formal municipal structures in South Africa required that large amounts of capital needed to be invested into upgrading a dilapidated municipal infrastructure. This dilapidated infrastructure came to be through poor or no maintenance by the authorities in charge of these areas. A number of reasons can be cited for this lack of maintenance such as poor management of resources, unqualified staff and poor administration of local government affairs. Whatever the reason, the fact stands that local government inherited an infrastructure which needs urgent upgrading, not only to raise the standard of services but also to obtain reasonable levels of safety for the public.

At the same time the Central and Provincial Governments decided unilaterally to reduce subsidies to local government (Circular on the introduction of the Equitable Share for local government: From 1 July 1998 onwards). This is especially the case with well-run municipalities. In most well run municipalities the subsidy allocation was reduced by central government at a rate of 30% per annum. This reduction in subsidy only further enlarged local government's need for additional financial resources.

To counterbalance the larger than normal need for capital and operating expenditure and diminishing governmental subsidies, local government must find additional sources of income. At the same time local government also have to reduce its expenditures by effective prioritisation in order to strike a balance between taxes raised and expenditures incurred. The raising of tariffs and taxes to an unsustainable level is not an option in the current socio-economic and political climate in South Africa. This is due to political pressure as well as growth limiting factors placed on local government by the Department of Finance. Other governing bodies such as the NER (National Electricity Regulator) also control the percentage increase in electricity tariffs. Before any taxes or tariffs can be implemented they have to be approved not only by the local council but also by the Department of Finance and, in the case of electricity, by the National Electricity Regulator.

Electricity and water distribution may in the near future be taken away from local government. A 10% cross subsidisation towards property rates was the acceptable norm to augment income from property rates. This cross subsidisation was done to spread the tax burden over a broader basis by including those users of infrastructure who do not own property. With the loss of these functions the subsequent loss of revenue will have a devastating effect on local government. Some relief in the form of a distribution volume percentage is promised but no commitments have been made and therefore local government cannot be assured that it will receive any compensation for the loss of these revenue-generating functions.

Alternative methods will therefore have to be found to broaden the tax base for local government. The purpose of broadening the tax base of local government is to pull other role-players within the municipal area into the tax net. This study aims to address the broadening of the local government tax base, and on a global scale to study alternatives to the current system followed in South Africa. To logically study international alternatives, Canada, Australia and England were chosen as target countries. The reason these countries were chosen is based on the fact that they are, or at some time in the past were, under British rule. As well, all four countries (Canada, Australia, England and South Africa) are following the British format of local government and similarities can more easily be drawn between the different legislation applied in each country respectively.

By implementing best practises from the target countries the tax base in South Africa can be broadened by incorporating other role players, within the area of municipal jurisdiction, into the tax net.

## 1.4 Objectives Of This Study

### 1.4.1 Main Objective

The primary objective is to, through theoretical research, questionnaires and interviews, draft a model, which will aid local government in South Africa to broaden its tax base.

### 1.4.2 Sub Objectives

The purpose of the sub-objectives is to investigate current local government taxation procedures and principles and budgetary procedures implemented at local authorities in Australia, Canada, England and South Africa. This will be achieved by:

- Investigating and providing best practises for local government from an international/global perspective.
- Financial modelling of best practises and the application thereof to the South African scenario.
- Providing an insight into international practises prioritising expenditure so as to strike a balance between local government taxation and accountability.

## 1.5 Defining The Field Of Study

This study will cover the topics of property and other local government taxation as well as the prioritisation of expenditures to ensure accountability to all stakeholders.

The sphere of local government taxation is heavily regulated and it is sometimes difficult to find alternative solutions to broaden the tax base. Local government in South Africa may have to request some legislation changes to enable them to bring about a change in the taxation structure as it now stands. Now is the opportune time to request these changes as property tax legislation is in the process of being reviewed by central government.

## 1.6 Research Methodology

This academic study is dealing with the background of local government in South Africa and the financial dilemma local government finds itself in. The study is focussed on municipal taxation as revenue source and the broadening of that revenue base. A secondary focus point is the prioritisation of expenditures to ensure that the available revenue sources are sufficient for sustainable local government. Specific attention is given to practises followed in Australia, Canada and England. All four countries follow the traditional British form of local government as they all have in the past been under British rule.

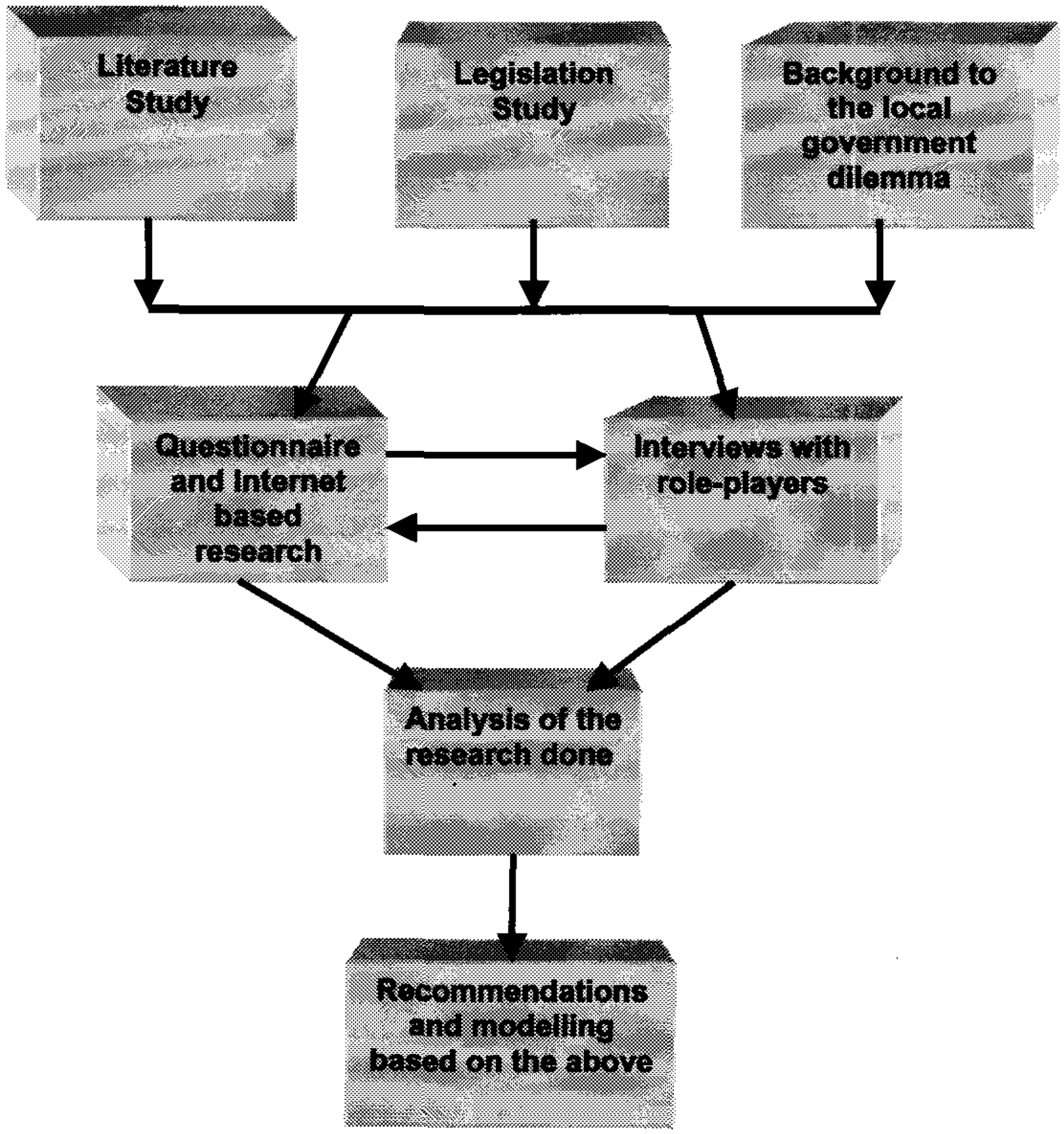
Against this background a questionnaire and interview process as well as Internet resources have been used to determine what sources of taxation and prioritisation of expenditures local government uses in the target countries. A substantial amount of information could be obtained from Internet resources as a number of local authorities use this media form to communicate with their ratepayers. The gathered information from all four countries was analysed.

In addition to the legislation and questionnaire an in depth study of available literature was made to further augment the research. Previous studies into local government finance (Credit Management for Local Government) in South Africa have shown that a very limited amount of literature on this subject is available. The available literature has nevertheless shown the dilemma local government in South Africa finds itself in. One of the solutions to this dilemma is to broaden the tax base. The other being the effective prioritisation of budgets.

The results from the analysis were used to develop a model, which will not only broaden the tax base of local government in South Africa but also provide a framework for the prioritisation of expenditures.

After completion of the study, the developed recommendations were sent to a number of local authorities in South Africa for their comments. The study and recommendations were then amended where necessary to accommodate these comments. This was done to ensure the practicality of the recommendations in the South African scenario.

**Figure 1.1 Research Methodology - An Illustration**



## 1.7 Limitations To The Study

This study investigates and researches best practises in local government taxation and financial prioritisation as followed by local government in Australia, Canada, England and South Africa. Other countries outside the target countries do not form part of the study although some benefit may have been gained from their best practises.

## 1.8 Terminology

Definitions and terminology used in this study are, due to their extensiveness, contained in ***Appendix 1*** at the end of the document.

## 1.9 Layout Of The Study

The rest of the study is divided into the following chapters:

- **CHAPTER 2: BACKGROUND TO THE DILEMMA OF LOCAL GOVERNMENT IN SOUTH AFRICA WITH SPECIFIC REFERENCE TO LOCAL GOVERNMENT TAXATION.**
  This chapter will provide the reader with crucial information on the functions of local government and the role it plays in modern society. It also deals with the fundamental principles of property tax. The financial versus political dilemma local government in South Africa finds itself in is also described.

- **CHAPTER 3: THE COLLECTION AND ANALYSIS OF DATA.**
  The methods followed to collect data for the study is described and the data is analysed. Due to the openness of communication by local authorities in three of the countries a large portion of the data could be collected directly off the official web pages of international cities. Financial data is analysed in such a way that the actual monetary value

of a revenue resource is transcribed into a percentage of total revenue rather than bringing exchange rates into the equation.

- **CHAPTER 4: LOCAL GOVERNMENT TAX LEGISLATION IN SOUTH AFRICA AND THE IMPLEMENTATION THEREOF.**
  This chapter contains an overview of current local government tax legislation and the implementation thereof in South Africa. By understanding the current South African legislation the differences in international legislation and practises becomes clearer.

- **CHAPTER 5: LOCAL GOVERNMENT TAX LEGISLATION IN AUSTRALIA, CANADA AND ENGLAND AND THE IMPLEMENTATION THEREOF.**
  Legislation of the three target countries is discussed with the aim to inform the reader on international practices. This information is needed to understand and apply the international models to the South African Scenario.

- **CHAPTER 6: APPLYING THE AUSTRALIAN, CANDIAN AND BRITISH MODELS TO THE SOUTH AFRICAN SCENARIO.**
  A comparison between the different models is made and best practises are identified. These best practises are then applied to a financial model using the South African model as base. The aim is to show the improvements international best practises can have on the South African Model should they be applied.

- **CHAPTER 7: IDENTIFYING POSSIBLE AMENDMENTS NEEDED TO SOUTH AFRICAN LEGISLATION.**
  Due to the prescriptive nature of local government legislation in South Africa it will be necessary to amend selected areas of the legislation to accommodate the best practises. After analysis of the various sets of legislation suggested amendments is indicated.

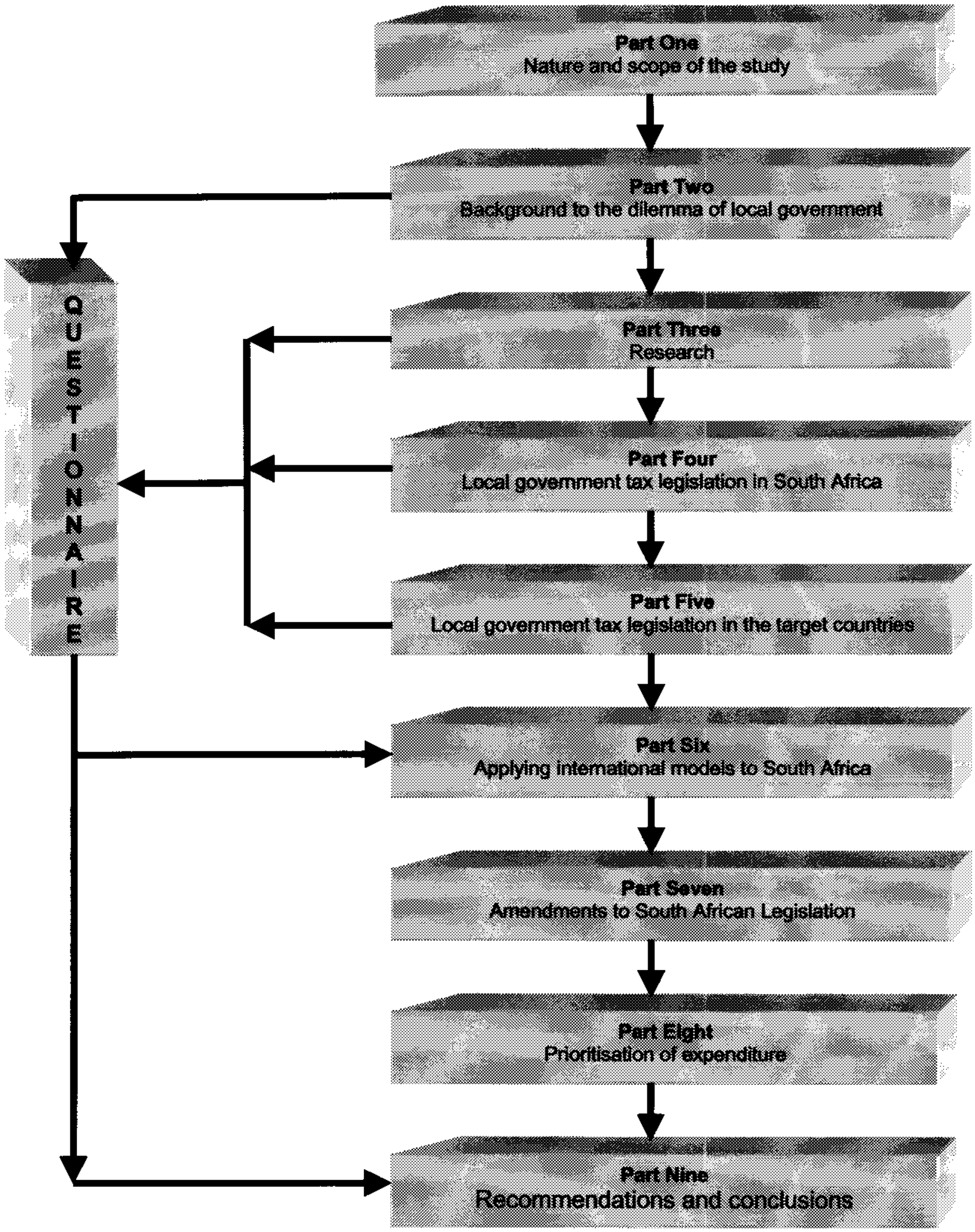
- **CHAPTER 8: PRIORITISATION OF LOCAL GOVERNMENT EXPENDITURE AND ACCOUNTABILITY.**

  The importance of budget prioritisation is shown in this chapter. International best practises are again used as benchmark. Various budget principles are discussed and suggestions are made on principles that should be included in the local government budget process. It also shows the need for effective communication by local government to the people and media.

- **CHAPTER 9: CONCLUSIONS AND RECOMMENDATIONS.**

  Recommendations are made to local government functionaries on alternative tax revenue resources, legislation changes and budget prioritisation procedures. The importance of open communication is also addressed

**Figure 1.2 Layout of the Study**



# CHAPTER TWO

# BACKGROUND TO THE DILEMMA OF LOCAL GOVERNMENT IN SOUTH AFRICA WITH SPECIFIC REFERENCE TO LOCAL GOVERNMENT TAXATION.

## 2.1 Introduction

As a starting point one's mind must be clear on what local government is and what local government's duties and functions are under current local government legislation in South Africa. Without a clear understanding of local government it is near impossible to understand the financial dilemma local government finds itself in as far as property and other taxation revenue goes.

Local government plays a large and important role in modern society. It provides essential services such as the provision of potable water, and refuse and sewerage removal. Through proper planning it promotes local interests by creating and maintaining a safe environment to live in. It is a leading partner in efforts to provide sustainable development by providing the infrastructure needed for development and it tackles difficult local social, economic and environmental problems on behalf of its ratepayers. It is therefore unimaginable that a modern society can effectively exist without functional local government. According to Musgrave (1959) the public sector has three basic functions namely stabilisation, distribution and allocation. By guaranteeing economic stability the government can maintain stable levels of employment, prices and economic growth in general. This holds some level of truth for local government as well.

To further enhance that understanding it is necessary to look at the Municipal Systems Act. Of importance here is Section (4)(2) of the Act (Municipal Systems Act, Act No. 32 of 2000), which states that:

*The council of a municipality, within the municipality's financial and administrative capacity and having regard to practical considerations, has the duty to -*

*a) Exercise the municipality's executive and legislative authority and use the resources of the municipality in the best interests of the local community;*
*b) Provide, without favour or prejudice, democratic and accountable government;*
*c) Encourage the involvement of the local community;*
*d) Strive to ensure that municipal services are provided to the local community in a financially and environmentally sustainable manner;*
*e) Consult the community about -*
    *I. The level, quality, range and impact of municipal services provided by the municipality, either directly or through another service provider; and*
    *II. The available options for service delivery*
*f) Give members of the local community equitable access to the municipal services to which they are entitled*
*g) Promote and undertake development in the municipality*
*h) Promote gender equity in the exercise of the municipality's executive and legislative authority*
*i) Promote a safe and healthy environment in the municipality; and*
*j) Contribute, together with other organs of state, to the progressive realisation of the fundamental rights contained in sections 24, 25, 26, 27, and 29 of the Constitution.*

The Act goes on in setting the general duties of a municipality in Section 71 of the Act (Local Government Systems Act, Act No. 32 of 2000) where it states

*1) A municipality must give effect to the provisions of the constitution and*
    *a) Give priority to the basic needs of the local community*
    *b) Promote the development of the local community; and*

c) *Ensure that all members of the local community have access to at least the minimum level of basic municipal services*

2) *Municipal services must -*
   a) *Be equitable and accessible*
   b) *Be provided in a manner that is conducive to -*
      I. *The prudent, economic, efficient and effective use of available resources; and*
      II. *The improvement of standards of quality over time*
   c) *Be financially sustainable*
   d) *Be environmentally sustainable; and*
   e) *Be regularly reviewed with a view to upgrading, extension and improvement*

The delivery of basic municipal services to all communities is dependent on the effective performance of local government. A local government which, does not collect its charges, does not provide a safe infrastructure and provide transparent administration will very soon be out of the resources needed to provide basic services to its community. The final shape, capacity and performance of local governments in South Africa will have direct implications for the political, social and economic fabric of the society.

It is however not only local government that has to perform in the relationship between ratepayers and council. The members of the local community also have rights and duties. These rights and duties are set out in Section 5 of the Municipal Systems Act. (Municipal Systems Act, Act No. 32 of 2000).

1) *Members of the local community have the right-*
   a) *Through the mechanisms and in accordance with processes and procedures provided for in this Act or other applicable legislation to-*

      *Contribute to the decision-making processes of the municipality; and*

Submit written or oral recommendations, representations and complaints to the municipal council or another political structure or a political office bearer or the administration of the municipality.

b) To prompt responses to their written or oral communications, including complaints, to the municipal council or to another political structure or a political office bearer or the administration of the municipality;
c) To be informed of decisions of the municipal council, or another municipal structure or any political office bearer of the municipality, affecting their rights, property and reasonable expectations.
d) To regular disclosure of the state of affairs of the municipality, including its finances;
e) To demand that the proceedings of the municipal council and those of its committees must be -

   I. Open to the public, subject to section 20

   II. Conducted impartially and without prejudice; and

   III. Untainted by personal self interest

f) To the use and enjoyment of public facilities; and
g) To have access to municipal services, which the municipality provides, provided the duties set out in subsection (2)(b) are complied with.

2) Members of the local community have the duty to -

a) When exercising their rights, to observe the mechanisms, processes and procedures of the municipality
b) Where applicable, and subject to section 97 (1)(c), to pay promptly service fees, surcharges on fees, rates on property and other taxes, levies and duties imposed by the municipality;
c) To respect the municipal rights of other members of the local community

*d) To allow municipal officials reasonable access to their property for the performance of municipal functions; and*

*e) To comply with the by-laws of the municipality applicable to them.*

Local governments in South Africa have a constitutional responsibility for ensuring the delivery and management of local services which are essential for both economic growth and social equity, including bulk and reticulated electrical power, water and sanitation, roads and waste removal. In addition they have responsibilities for community facilities (such as sports fields) and, to a limited extent, some social services (such as municipal health clinics). In some of the target countries these responsibilities are even broader as they include schools, social services and to limited extent policing. It is commonplace that significant investment in the infrastructure necessary for the delivery of these services and facilities is required. (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000).

In short, the purpose of local government is:

a) To provide good government.

b) To provide services, facilities, or other goods that, in the opinion of council, are necessary or desirable for all or a part of the municipality.

c) To develop and maintain safe and viable communities.

## 2.2 Functions of Local Government

In South Africa a number of functions have been delegated to local government by either Central and/or Provincial Government. These functions may vary between local authorities but the following major functions are found at most of the local authorities.

1) Electricity distribution.

Electricity is purchased in bulk by the local authority and then distributed to each consumer connected to its distribution network whether industrial, commercial or residential. The provision and maintenance of the network is the responsibility of the local authority. A third party generates the actual electricity flowing through the network. Consumption is metered and the consumers must pay for their electricity consumption. This function is seen as a commercial activity and must therefore carry its own cost through a tariff structure approved by council. In South Africa the standard practise is to allocate a portion of this revenue to the property tax revenue account as a cross subsidisation.

2) Water distribution.

Potable water is purchased in bulk from a Regional Water Board and then distributed to the consumers. In some instances in South Africa, the local authority does water purification itself. This is not the norm but rather the exception. As with electricity the provision and maintenance of the distribution network is the responsibility of the local authority. This commercial activity must pay for itself and is therefore metered and paid for by the consumers.

3) Refuse removal.

Most local authorities operate their own refuse dumps. The operations at these dumps are, however, strictly controlled by Central Government due to the pollution risk posed to the natural water sources of the country as a whole. Refuse in residential areas is removed on a regular basis. At commercial and industrial enterprises the same service takes place only in larger quantities and on a more regular basis. In South Africa recycling is still on a very low key and the operating of disposal sites is costly due to the high volumes of waste. All users of this service must therefore contribute to cover the costs. The more refuse a person generates the larger his contribution to the cost will be. In the other three countries forming part of the study recycling of waste is strongly encouraged by local government and the private sector.

4) Sewerage and Industrial outflow.
   The provision and maintenance of the network together with the treatment of the outflow is covered under this function. All the raw sewage and industrial outflow needs to be treated in some way or another before it can be released into the environment. Here again strict regulations from Central Government are in place to ensure that pollution of the environment does not take place. Most local authorities operate their own treatment plants. Coastal local authorities on the other hand have in the past, and in some cases still do, pump their macerated outflow into the ocean. The users of the waterborne sewer system must also contribute to cover the cost of the system.

5) Roads and Storm water.
   The internal road and storm water infrastructure is the responsibility of the local authority. This includes the provision and maintenance of the infrastructure. All inhabitants in the local authority's area are using or enjoying the benefits of the road and storm water infrastructure. Revenue to cover expenses for this service comes from property tax.

6) Emergency services.
   The local authority does fire fighting and fire prevention as well as rescue services and disaster management.

7) Health services.
   This encompasses services such as municipal clinics, environmental health and pollution control within the boundaries of the local authority. In areas where Malaria is prevalent the control and monitoring of vector mosquitoes are also included. With the high incidence of AIDS in South Africa many local authorities have also incorporated AIDS Information Centres under their health services.

8) Traffic control.

Traffic control within the municipal boundaries falls within the jurisdiction of local government. The Provincial Government controls all other traffic. In some larger local authorities the function of policing has also been taken over by the local authority. This, however, is the exception rather than the rule.

9) Public libraries.

Although this function is highly subsidised by Provincial Government the bulk of the costs are carried by local government.

## 2.3 Property Tax

Municipalities need a reliable source of revenue to protect public health, assure public safety, fulfil its functions and safeguard the local environment. Property rates are the most important source of general revenue for municipalities, especially in developed areas. Revenue from property rates is used to fund services that benefit the community as a whole as opposed to individual households. These include installing and maintaining streets, sidewalks, lighting, and storm drainage facilities, and building and operating clinics, parks, and recreational facilities. Property rates revenue is also used to fund municipal administration, such as equipment and stationary, and costs of governance, such as community and council meetings.

Property rates are set, collected, and used locally. National and provincial governments do not impose these taxes nor do they share in the revenue collected. National government however, through legislation, prescribes how this tax must be implemented. The local council therefore has discretionary powers over the utilisation of the revenue. As a norm it is applied towards the provision of non-economic services and other functions that do not generate sufficient revenue to cover costs.

Property Tax is a levy that is imposed primarily upon land and buildings and forms the main source of revenue for local government in South Africa. Property

Tax forms on average, 28% of the total local government income of a municipality (Chart 3.4). In a simple rural economy composed of comparable households, property valuation may provide a fairly good indicator of both ability to pay and benefits from public services. In a complex urban, industrial society this is no longer true. In the South African scenario where sections of a community have been given houses, but due to unemployment cannot afford to pay for services and taxes, property values can no longer be seen as an indicator of payment ability.

One of the most difficult problems in taxing property is to find a reasonable basis of assessment. The most commonly used is to attach a value of some sort to a property and then use this value as a basis from which to calculate the property tax.

There are three principal approaches to the assessment of property rates. They are rental value, capital value and market value. Under the rental value principle, the tax is based on the average gross-rental income the property is expected to generate under prevailing market conditions. The capital value principle determines that the capital value can be estimated on the basis of rental values, treating them as earnings on capital. The market value principle determines that the amount a property might be expected to realise if a willing seller sells to a willing buyer will be used as base for the assessment.

Responsibility for the various phases of administration of property tax rests entirely upon local government officials. They are involved in the identification of the property to be taxed, its valuation, the application of the appropriate tax rate, and collection. Each property owner is billed on a regular basis and the revenue derived from property tax is paid into a pool from which the local government must finance its operations.

Property taxation finances local government, not fully but enough to make the independence of local government meaningful as it enables a community to exercise a degree of choice. The revenue from property rates is discretionary and the community, through its elected councillors, can to a degree influence the utilisation of the revenue. Central or Provincial Government on the other hand also place limitations on this discretion. The extent to which local governments have control over property taxes is often an important determinant of their ability to make autonomous expenditure decisions (Bird and Slack, 2004). The balance of the revenue normally comes from surpluses on commercial activities and to lesser extent government grants, which are normally program specific.

As was stated before, the revenue is not enough to finance local government fully and therefore it is important to develop new revenue sources to make local government more independent and truly an instrument of the community.

## 2.4 Local Government Budget

In South Africa a local government's budget can typically be summarised as follows:

**Table 2.1 Typical Local Government Budget**

| Description | Expenditure | Revenue | Surplus/ (deficit) |
|---|---|---|---|
| Rates and General | 164,000,000 | 95,283,000 | (68,717,000) |
| Electricity Services | 226,000,000 | 234,906,000 | 8,906,000 |
| Water Services | 72,000,000 | 68,868,000 | (3,132,000) |
| Refuse Services | 20,000,000 | 19,811,000 | (189,000) |
| Sewerage Services | 31,000,000 | 30,189,000 | (811,000) |
| Other | | 35,989,000 | 35,989,000 |
| Government Grants | | 28,954,000 | 28,954,000 |
| | | | |
| Total | 513,000,000 | 514,000,000 | 1,000,000 |

Electricity and water services are seen as commercial services and the tariffs and fees charged to users are set to such a level that the service must show a surplus. Due to central government's policy of free basic services the water account shows a loss. A portion of the utility revenue (normally not more than 10% of gross revenue) is utilised as cross subsidisation towards the Rates and

General account. The principle behind this cross subsidisation is sound. In a highly populated area, users of municipal services, who do not necessarily own property in the municipal area of jurisdiction, also contribute towards those services for which no direct user fees are charged. This cross subsidisation can be seen as a form of indirect taxation.

Refuse and Sewerage services can be classified as economic services with the fees set at such a level to balance revenue and expenditure as close as possible. All other costs such as road maintenance, parks and recreation, emergency services etc. have to be paid for out of the revenue under the rates and general account. This account receives revenue from the following sources:

**Table 2.2 Rates and General Account Resources**

| Description | Amount | Percentage |
|---|---|---|
| Property Rates | 73,928,000 | 46,14 |
| Subsidy from Electricity Services | 21,355,000 | 13,33 |
| Subsidy from Water Services | 0 | 0 |
| Sundry charges and Fees | 35,989,000 | 22,46 |
| Government Subsidy | 28,954,000 | 18,07 |
| | | |
| Total Rates and General | 160,226,000 | 100,00 |

As can be seen from the above two tables, local government is largely dependent on the revenue amount raised from property tax to provide the services and functions prescribed by local government legislation.

The politicians on local as well as central government level are placing ever-growing demands on local government in the form of services it must provide to the inhabitants in its area. These functions need to be funded from somewhere and with ever diminishing aid from central and provincial government, local government must find the resources from within. One way to increase the revenue is to increase property tax. The question is to what level it (property rates) can be increased before formal resistance from the ratepayers will result in mass refusals to pay. Under the current legislation, where central government promotes relief measures for the poor and the right to free basic services, this legislation is not very flexible. Alternatively local government must cut back on its expenditure. This is not always possible due to political pressure placed on the administration to perform certain services or complete certain projects. The political need for services and new projects must be recognised but through skilful prioritisation the expenditure must be kept within what is affordable for local government as well as the community. This will call for some hard decisions from the politicians.

The best solution to the financial dilemma local government is currently experiencing is to find a balance between additional taxation of the community as a whole and the prioritisation of expenditure to obtain sustainable local government.

Local government therefore must seek a solution which will broaden the tax base and therefore increase revenue from other sources than direct property tax, while on the other hand prioritising their budgets in such a way to deliver only the services it and the community needs and can afford.

## 2.5 Summary

Local government is charged with the responsibility to provide services, facilities and other goods that, in the opinion of council, are necessary or desirable for all or a part of the community. To partly finance this responsibility, it is given the authority to raise property taxes from the community.

The revenue raised in this way, only partly funds the expenditure necessary for the provision of services and infrastructure at the level expected by the politicians. The shortfall has to be made good from somewhere else, as central government grants are diminishing while the expectations of the politicians and the community are rising.

Alternative ways of increasing the revenue from property tax need to be found, as simply increasing the tax rate to the needed level is not feasible. The broadening of the tax base as well as strict prioritising of expenditure creates a good balance, which is conducive to sustainable local government.

# CHAPTER THREE

# THE COLLECTION AND ANALYSIS OF DATA

## 3.1 Introduction

This chapter deals with the collection of data for this study. The choice of data to collect is aimed at the empirical research to support this study. The data obtained as well as the analysis thereof is discussed in detail.

## 3.2 Data Sources and Questionnaire Design

During the study and analysis of local government tax legislation, as applicable to each country, a number of questions were identified. The questions dealt with statistical information as well as questions specifically aimed at acquiring an improved understanding of best practises in revenue generation through local government taxation.

In order to keep the questionnaire as short as possible other resources such as the World Wide Web were extensively utilised to obtain data. The World Wide Web search, as well as other documentation received from local authorities, proved of great value in providing answers to a large portion of the questions. This was especially true in obtaining statistical data such as budgets and revenue distributions.

Due to international differences in the application of property tax as well as differences in terminology separate questionnaires were developed for each country. Care was however taken to ensure that a 90% commonality factor was adhered to.

## 3.3 The Process of Gathering Data

At the start of the data collection process an equal number of cities in each country (Australia, Canada, England and South Africa) were randomly selected as target cities. The web sites of these cities were extensively researched to gather as much data as possible on their application of local government taxation. Other local government web-sites were also researched to obtain a wider understanding of local government taxation.

Unanswered questions and/or outstanding issues were then addressed by the customised (by country) questionnaire or through direct e-mail with local government practitioners in that country.

## 3.4 Results and Analysis

The results of the World Wide Web research as well as the questionnaire will now be discussed and analysed. The discussions are aimed at identifying the key areas that should form part of local government taxation in order to broaden the tax base. The data will also assist in making recommendations on how local government can prioritise its expenditures as well as to accomplish a higher level of accountability and transparency.

### 3.4.1. Feedback on World Wide Web Data and Questionnaires

A total of 40 cities were directly targeted in the research. 10 Cities in each country were randomly selected. 37 of these have extensive web presence and a large quantity of data could be obtained from this source. Other web-sites outside the four target countries were also visited to gain a broader understanding of international property taxation. The data collected from the web sites strengthens the questionnaire response and reliability of the data to the extent that a reasonable level of confidence can be placed in the information collected that it is representative of local government taxation practises in the target countries.

## 3.5. Results and Discussion of Data Collected

In order to analyse the data meaningfully each type of data will be discussed in terms of the following:

- **Introduction** - This will expand on the reason why the information rendered by the response is important.
- **Results obtained** - The results obtained in table format.
- **Conclusion** - The conclusion arrived at, by interpreting the obtained information. Broad recommendations will (where applicable) also be discussed.

### 3.5.1. Budget Information

#### 3.5.1.1. Introduction

The purpose of collecting budget related data is to determine the revenue distribution of each local authority. The distribution layout will clearly indicate the level of reliance on each revenue source in relation to the total revenue of that local authority. The data will then be further transposed into a country average. This calculated average would indicate local government's reliance on its own and central/provincial government's resources to finance operations.

Foreign currencies such as the Australian Dollar, Canadian Dollar and British Pound were not converted to SA Rand. For the purpose of this study the monetary value is of lesser importance than the relationship between the different revenue sources. The emphasis is therefore placed on the relationship between the respective revenue sources as their part of the whole.

## 3.5.1.2. Results Obtained

### 3.5.1.2.1. Australia

**Table 3.1. Revenue Distribution for Australia**

| City | Prop. Tax '000 | Other Municipal tax '000 | Gov. Grants '000 | Sales & Services '000 |
|---|---|---|---|---|
| Adelaide | 44,134 | 0 | 1,329 | 57,581 |
| Brisbane (region) | 802,348 | 0 | 81,695 | 197,495 |
| Canterbury | 37,499 | 0 | 9,744 | 25,556 |
| Darwin | 21,723 | 0 | 5,169 | 12,098 |
| Davenport | 12,731 | 0 | 2,644 | 12,341 |
| Hobart | 47,653 | 0 | 3,091 | 16,512 |
| Liverpool | 50,363 | 0 | 8,319 | 12,971 |
| Melbourne | 107,071 | 0 | 5,495 | 73,596 |
| Perth | 34,160 | 0 | 2,015 | 39,560 |
| Sydney | 94,828 | 0 | 3,004 | 70,326 |

For the purpose of this research the actual amounts are not of importance but rather the relationship of the revenue sources to each other. Therefore it is necessary to re-state the data in percentage form.

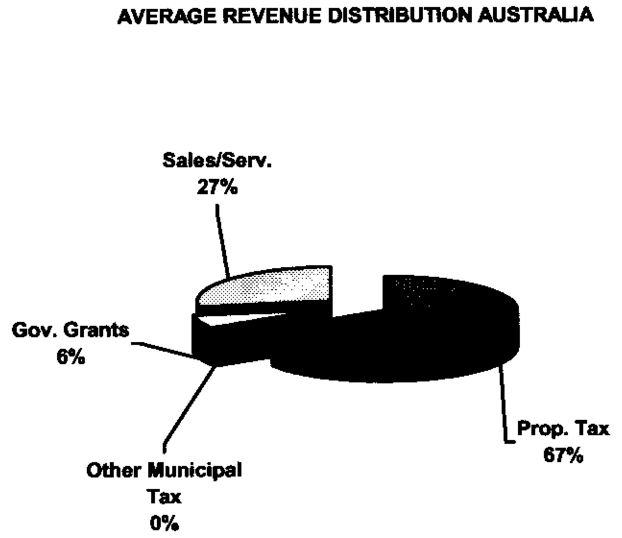
**Table 3.2. Revenue Distribution Percentages for Australia**

| City | Prop. Tax % | Other Municipal tax % | Gov. Grants % | Sales & Services % |
|---|---|---|---|---|
| Adelaide | 43.00 | 0.00 | 1.00 | 56.00 |
| Brisbane (region) | 74.00 | 0.00 | 8.00 | 18.00 |
| Canterbury | 52.00 | 0.00 | 13.00 | 35.00 |
| Darwin | 56.00 | 0.00 | 13.00 | 31.00 |
| Davenport | 46.00 | 0.00 | 10.00 | 45.00 |
| Hobart | 71.00 | 0.00 | 5.00 | 25.00 |
| Liverpool | 70.00 | 0.00 | 12.00 | 18.00 |
| Melbourne | 58.00 | 0.00 | 3.00 | 40.00 |
| Perth | 45.00 | 0.00 | 3.00 | 52.00 |
| Sydney | 56.00 | 0.00 | 2.00 | 42.00 |

Due to individual differences in the composition (residential, industrial or agricultural) of each local authority it is more logical to obtain an average revenue distribution for the purpose of determining reliance on the various revenue types.

By transposing the above Australian information into a country average the following result is obtained.

**Chart 3.1. Average Revenue Distribution Australia**




The above clearly shows that local government in Australia places a low reliance on government grants to help finance operations. It also shows that the largest source of revenue originates out of property tax indicating a broad tax base.

# 3.5.1.2.2. Canada

**Table 3.3. Revenue Distribution for Canada**

| City | Prop. Tax '000 | Other Municipal tax '000 | Gov. Grants '000 | Sales & Services '000 |
|---|---|---|---|---|
| Airdrie | 93,883 | 655 | 873 | 10,917 |
| Calgary | 661,700 | 203,800 | 32,100 | 299,400 |
| Edmonton | 455,387 | 46,116 | 24,834 | 418,110 |
| Lethbridge | 41,076 | 2,909 | 6,448 | 35,943 |
| Okotoks | 4,770 | 222 | 615 | 5,045 |
| Red Deer | 30,048 | 2,261 | 11,841 | 98,434 |
| Regina | 110,759 | 0 | 8,869 | 70,876 |
| Toronto | 2,970,485 | 0 | 1,431,571 | 2,343,430 |
| Vancouver | 433,039 | 0 | 7,078 | 381,362 |
| Winnipeg | 451,200 | 19,700 | 98,600 | 115,400 |

Of interest in the data contained in **Table 3.3. Revenue Distribution for Canada** is the effect of provincial legislation differences on municipal taxation. Notable is that three of the target cities do not raise linear or franchise taxes. **Table 3.4** shows the above data in percentage form.

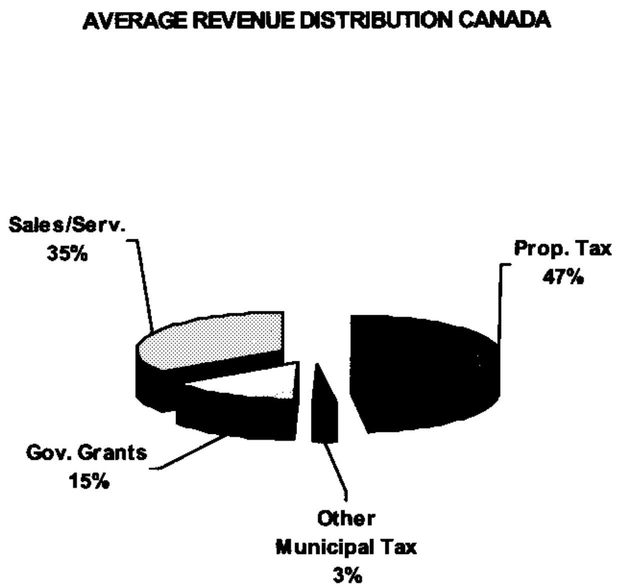
**Table 3.4. Revenue Distribution Percentages for Canada**

| City | Prop. Tax % | Other Municipal tax % | Gov. Grants % | Sales & Services % |
|---|---|---|---|---|
| **Airdrie** | 88.00 | 1.00 | 1.00 | 10.00 |
| **Calgary** | 55.00 | 17.00 | 3.00 | 25.00 |
| **Edmonton** | 48.00 | 5.00 | 3.00 | 44.00 |
| **Lethbridge** | 48.00 | 3.00 | 7.00 | 42.00 |
| **Okotoks** | 45.00 | 2.00 | 6.00 | 47.00 |
| **Red Deer** | 21.00 | 2.00 | 8.00 | 69.00 |
| **Regina** | 58.00 | 0.00 | 5.00 | 37.00 |
| **Toronto** | 44.00 | 0.00 | 21.00 | 35.00 |
| **Vancouver** | 53.00 | 0.00 | 1.00 | 46.00 |
| **Winnipeg** | 66.00 | 3.00 | 14.00 | 17.00 |

The extent to which cities utilise the opportunity to raise linear or franchise tax also varies due to the size of the city in relation to the level of infrastructure in place. It is logic that a utility company will be willing to pay tax at a higher rate when the customer base is large. This logic stands even though all or at least the bulk of the tax is passed on to the end user of the service.

Due to individual differences in the composition (residential, industrial or agricultural) of each local authority it is more logical to obtain an average revenue distribution for the purpose of determining reliance on the various revenue types. By transposing the above Canadian information into a country average the following result is obtained.

**Chart 3.2. Average Revenue Distribution Canada**




The above clearly shows that local government in Canada places a medium reliance on government grants to help finance operations. It also shows that the largest source of revenue originates out of property tax indicating a broad tax base. Other municipal tax in the chart above is derived from linear tax, which is a form of indirect tax placed on certain commercial entities operating within the city limits. When adding linear tax revenue to property tax it is clear that on average, 50% of local government revenue is derived from municipal taxation.

### 3.5.1.2.3. England

**Table 3.5. Revenue Distribution for England**

| City | Prop. Tax '000 | Other Municipal tax '000 | Gov. Grants '000 | Sales & Services '000 |
|---|---|---|---|---|
| Aberdeen | 73,133 | 64,247 | 164,829 | 118,852 |
| Cambridge | 30,452 | 36,072 | 69,412 | 23,314 |
| Dundee | 35,561 | 43,763 | 199,540 | 65,603 |
| Edinburg | 170,046 | 137,116 | 399,561 | 200,997 |
| Exeter | 25,934 | 4,177 | 21,629 | 26,558 |
| Lincoln | 17,550 | 3,117 | 26,332 | 15,821 |
| Liverpool | 128,000 | 278,000 | 507,000 | 157,000 |
| Manchester | 104,252 | 130,557 | 293,437 | 162,633 |
| Nottingham | 69,230 | 87,030 | 138,620 | 8,000 |
| Sunderland | 51,652 | 181,058 | 250,133 | 105,603 |

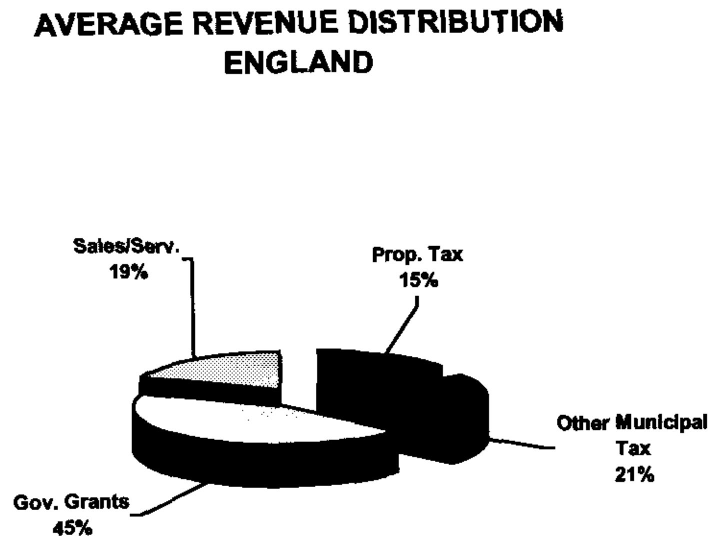
**Table 3.6.** shows the above information in percentage form.

**Table 3.6. Revenue Distribution Percentages for England**

| City | Prop. Tax % | Other Municipal tax % | Gov. Grants % | Sales & Services % |
|---|---|---|---|---|
| Aberdeen | 17.40 | 15.30 | 39.10 | 28.20 |
| Cambridge | 19.10 | 22.70 | 43.60 | 14.60 |
| Dundee | 10.00 | 13.00 | 58.00 | 19.00 |
| Edinburg | 19.00 | 15.00 | 44.00 | 22.00 |
| Exeter | 33.00 | 5.00 | 28.00 | 34.00 |
| Lincoln | 28.00 | 5.00 | 42.00 | 25.00 |
| Liverpool | 12.00 | 26.00 | 47.00 | 15.00 |
| Manchester | 15.00 | 19.00 | 42.00 | 24.00 |
| Nottingham | 22.90 | 28.70 | 45.80 | 02.60 |
| Sunderland | 08.80 | 30.80 | 42.50 | 17.90 |

Due to individual differences in the composition (residential, industrial or agricultural) of each local authority it is more logical to obtain an average revenue distribution for the purpose of determining reliance on the various revenue types. By transposing the above British information into a country average the following result is obtained.

**Chart 3.3. Average Revenue Distribution for England**




The above clearly shows that local government in England places a high reliance on government grants to help finance operations. It also shows that local authorities in England have a narrow tax base. Even with property and other municipal tax added together the combined revenue is still less than government grants received.

### 3.5.1.2.4. South Africa

**Table 3.7. Revenue Distribution for South Africa**

| City | Prop. Tax '000 | Other Municipal tax '000 | Gov. Grants '000 | Sales & Services '000 |
|---|---|---|---|---|
| Durban | 2,256,300 | 0 | 345,700 | 4,544,100 |
| Grahamstown | 17,501 | 0 | 10,925 | 55,832 |
| Johannesburg | 2,518,000 | 0 | 308,654 | 6,762,988 |
| Pretoria | 1,142,869 | 0 | 101,219 | 3,251,989 |
| Richards Bay | 95,283 | 0 | 28,954 | 388,763 |
| Stellenbosch | 42,527 | 0 | 8,860 | 170,107 |
| Ladysmith | 20,916 | 0 | 3,693 | 62,357 |

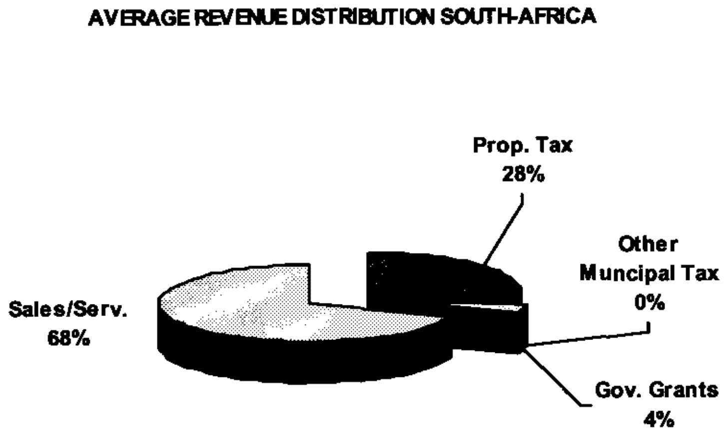
**Table 3.8** shows the above data in percentage form.

**Table 3.8. Revenue Distribution Percentages for South Africa**

| City | Prop. Tax % | Other Municipal tax % | Gov. Grants % | Sales & Services % |
|---|---|---|---|---|
| Durban | 31.60 | 0.00 | 4.80 | 63.60 |
| Grahamstown | 20.77 | 0.00 | 12.97 | 66.26 |
| Johannesburg | 26.30 | 0.00 | 3.20 | 70.50 |
| Pretoria | 25.40 | 0.00 | 2.30 | 72.30 |
| Richards Bay | 18.60 | 0.00 | 5.60 | 75.80 |
| Stellenbosch | 19.20 | 0.00 | 4.00 | 76.80 |
| Ladysmith | 23.94 | 0.00 | 4.23 | 71.83 |

Due to individual differences in the composition (residential, industrial or agricultural) of each local authority it is more logical to obtain an average revenue distribution for the purpose of determining reliance on the various revenue types. By transposing the above South African information into a country average the following result is obtained.

**Chart 3.4. Average Revenue Distribution for South Africa**




The above clearly shows that local government in South Africa places a low reliance on government grants to help finance operations. It also shows that the largest source of revenue originates out of the selling of consumer services. Property tax on the other hand forms the second largest revenue source indicating a fairly narrow tax base.

## 3.5.1.3. Conclusion

With the exception of England it can be clearly stated that local government functions with a low reliance on central or provincial government financing. This has the advantage that local government can stay relatively autonomous in its decision-making processes.

It can also be deduced from the data analysed that the most important source of revenue for local government, again with the exception of England, is property tax. This emphasises the importance of local government taxation as a revenue source. Local government should protect and develop this source to its fullest.

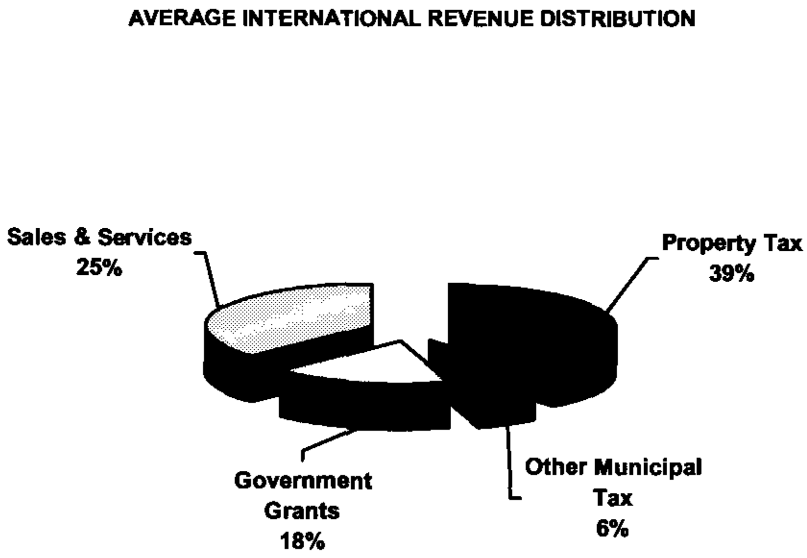
## 3.5.1.3.1. International Trend

**Table 3.9. International Revenue Distribution Percentages**

| Country | Property Tax | Other Municipal Tax | Government Grants | Sales & Services |
|---|---|---|---|---|
| **Australia** | 67% | 0% | 6% | 27% |
| **Canada** | 47% | 3% | 15% | 35% |
| **England** | 15% | 21% | 45% | 19% |
| **South-Africa** | 28% | 0% | 4% | 68% |
| **Average** | 39.25% | 6.00% | 17.50% | 37.25% |

Graphically shown the average trend internationally is depicted in the chart below.

**Chart 3.5. Average International Revenue Distribution**




## 3.5.1.3.2. Comparison with Average Trend

In comparing the four individual countries with the calculated straight average for these countries combined one very quickly see that three of the sets of figures on which these averages are based are out of line. These three would be the high reliance England places on government aid, the high reliance in South Africa on revenue generated from the sales of services and the high reliance Australia places on revenue generated from property tax.

Also evident from the above is that both England and Canada use alternative sources of taxation to spread the tax burden over a larger base.

## 3.5.2. Frequency of Valuations

### 3.5.2.1. Introduction

The purpose of collecting valuation frequency data is to determine how current the valuation data is on which property tax is based. It is important for local authorities to value all properties on a regular basis as this ensures that relative current market value is used in calculating the property tax.

By not valuing on a regular basis the property tax does not represent the true value of the property and therefore loses its fairness as taxation. It also negatively impacts on the potential revenue from property taxation.

### 3.5.2.2. Results Obtained

#### 3.5.2.2.1. Australia

The various sets of provincial legislation differ in the sense that valuation intervals vary from yearly to once in three years. This excludes interim valuations which takes place as needed.

#### 3.5.2.2.2. Canada

Local government in Alberta, Canada is required by Law (Municipal Government Act, Chapter 26 of 1994) to value and assess all properties in the municipality. Section 285 of the Act (MGA, Chapter 26 of 1994) requires the municipality to prepare an annual assessment for each property whilst Section 302 of the same Act stipulates that an assessment roll must be prepared on an annual basis.

The above excludes interim valuations and assessments, which take place as soon as a property's value changes due to further improvements.

### 3.5.2.2.3. England

Central Government pays for evaluation and therefore determines the frequency of valuations. This has not taken place for a number of years. The values are therefore outdated and some properties are possibly in the wrong band due to the out of date valuations.

### 3.5.2.2.4. South Africa

Prior to the Property Tax Act local government in each Province were ruled by its own ordinance. Valuations were required at least every five years but could be done more frequently, maximum of one per year, if the local authority so wished. The new Property Tax Act now requires that valuations be done at least every four years.

### 3.5.2.3. Conclusion

The frequency of property valuation is not a constant in the four countries forming part of this research. What is however clear is that properties need to be valued on a regular basis to ensure the fairness of property rates as a tax. One could safely deduce that properties should at least be valued every three to four years.

## 3.5.3. Basis of Valuation

### 3.5.3.1. Introduction

The purpose of collecting data on the basis of valuation is to determine the valuation composition most frequently used. The valuation could be based on unimproved land value, only the value of improvements, or land and improvements together. Each reflects its own relation to the representation of wealth of the owner of the property and his ability to pay taxes.

### 3.5.3.2. Results Obtained

#### 3.5.3.2.1. Australia

Valuations are based on land value, which in the Australian concept includes improvements. Under the Queensland legislation the average of the last three valuations is used to calculate tax.

#### 3.5.3.2.2. Canada

In Canada the total market value of the property is used as basis to calculate tax. The combined value is rated at one level and there is no distinction between land/improvement values.

#### 3.5.3.2.3. England

In England houses are classified in bands and the band value is used in determining the tax. The actual market value is not used.

#### 3.5.3.2.4. South Africa

Total market value is used in determining property tax.

### 3.5.3.3. Conclusion

Except for England the other three counties base their property tax on the market value of land and improvements combined. Some interesting variations such as the Queensland model were found.

## 3.6 Summary

The data gathered through the research showed that the relationship between property tax revenue and total revenue differs from country to country, The main factor being the extent to which central government provides financial resources to local authorities in that country. Property tax however still forms an important revenue source for local government. Local government has discretionary spending authority over this revenue source. South Africa's reliance on this revenue source is the second lowest of the countries forming part of this research.

The research done clearly showed that properties need to be valued on a regular basis. This not only ensures the fairness of property tax as a form of taxation but also ensures that the local authority receives the maximum potential revenue from this source.

Valuations were mostly based on the market value of the property. This market value included land and buildings.

The data, analysis and results will be used in later deliberations to substantiate recommendations on the improvement of revenue sources.

# CHAPTER FOUR

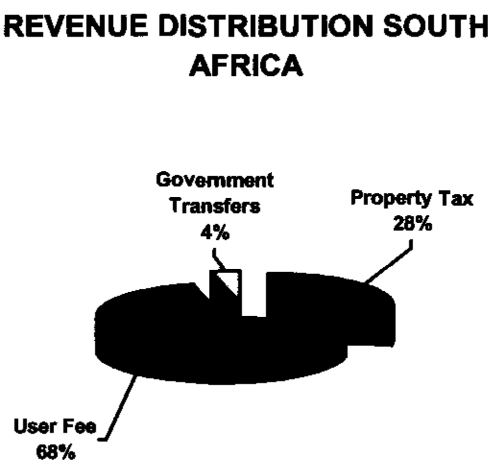
# LOCAL GOVERNMENT TAX LEGISLATION IN SOUTH AFRICA AND THE IMPLEMENTATION THEREOF.

## 4.1 Introduction

Over the past decade, local government in South Africa has seen dramatic changes in so far as legislation goes. A number of Acts were promulgated over a short period of time and new legislative changes are still being made. This quick succession of legislation and the dependency of the various Acts on each other makes the task of the municipal manager that much more difficult.

Local government in South Africa derives its revenue from the same sources as international local authorities namely, property tax, government grants and sales and services. The following chart shows the average revenue distribution for South Africa. The differences in revenue distribution will be discussed in a later chapter.

**Chart 4.1. Revenue Distribution in South Africa**



When analysing local government tax in South Africa, it is imperative to read all applicable legislation together, and form a broader picture of local government tax legislation to be implemented. In addition to this the bigger picture becomes clearer when changes and the rational thereof is followed and analysed. Local government taxation was traditionally seen as "property tax" or "property rates" and nothing else. This viewpoint has led to the deterioration or narrowing of a local authority's tax base to the point where a mammoth effort is needed to once again broaden the tax base.

Property rates represent a major revenue source for local government, and are as such the main source of discretionary tax revenue for municipalities. Historically property rates were levied only in towns and cities, therefore being an especially important source of revenue in urban areas. Rating was, historically, also done differently in the various provinces. Each of the former four provinces had its own legislation, and its own system of valuation and rating. As noted in the White Paper on Local Government (1998), a simpler and more uniform system was needed as part of local government reform.

## 4.2 Legislation

According to the Municipal Systems Act (Act No. 32 of 2000) the council of a local authority has the right to finance its affairs by charging fees for services and imposing surcharges on fees, rates on property and, to the extent authorised by national legislation, other taxes, levies and duties. What is of specific interest in this study is the rating of properties and the local authority's right to impose taxes, levies and duties.

The various Provincial ordinances have firstly, as far as property rates are concerned, been replaced by the Local Government Transition Act (Act No. 209 of 1993). Since its enactment all property rates were raised under the authority of this Act together with the various Provincial Ordinances. Section 7 of the Act (Local Government Transition Act No. 209 of 1993) provides this authority by stating:

*a) (I) A local council, metropolitan local council and rural council may by resolution, levy and recover property rates in respect of immovable property in the area of jurisdiction of the council concerned: Provided that a common rating system as determined by the metropolitan council shall be applicable within the area of jurisdiction of that metropolitan council.*

*(ii) A municipality may by resolution supported by a majority of the members of the council levy and recover levies, fees, taxes and tariffs in respect of any function or service of the municipality.*

*b) In determining property rates, levies, fees, taxes and tariffs (hereinafter referred to as charges) under paragraph (a), a municipality may -*

*h) Differentiate between different categories of users or property on such grounds as it may deem reasonable*

The above-mentioned Act (Local Government Transition Act No. 209 of 1993) however allowed each local authority which does not fall under a metropolitan council to raise property rates in its own unique way. This created a perception that all ratepayers in the country were not treated equally. In an effort to ensure that all local authorities in South Africa use the same basis for raising property rates the central government has started with legislation specifically dealing with the raising of property rates. The Local Government Property Rates Act (2004) had that purpose. As such it establishes a uniform system of regulation and lays down the parameters that are necessary to avoid material and unreasonable prejudice to national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital and labour.

The Local Government Property Rates Act, 2004 determines that:

*Section 2 - Power to levy rates*

*1) A metropolitan or local municipality may levy a rate on property in its area.*

2) *A district municipality may not levy a rate on property except on property in a district management area within the municipality*
3) *A municipality must exercise its power to levy a rate on property subject to-*
   a) *Section 229 of the Constitution and any other applicable provisions of the constitution.*
   b) *The other provisions of this Act; and*
   c) *The rates policy it must adopt in terms of section 3*

This clearly sets out the right of the different types of municipalities to levy property rates on property falling in its area of jurisdiction.

The Local Government Property Rates Act (2004) sets out the basis on which property rates should be calculated and levied.

The Local government Property Rates Act (Act No. 6 of 2004) reads as follows:

*Section 11 - Amount due for rates*

1) *A rate levied on property must be an amount in the Rand-*
   a) *On the market value of the property;*
   b) *In the case of public service infrastructure, on the market value of the public service infrastructure less 30% of that value as contemplated in section17 (1)(a), or on such lower percentage as the Minister may determine in terms of section 17(4); or*
   c) *In the case of property to which section 17(1)(h) applies, on the market value of the property less the amount stated in that section, or on such other amount as the Minister may determine in terms of section 17(3).*
2) *A rate levied by a municipality on properties with a market value below a prescribed valuation level may, instead of a rate determined in subsection (1), be a uniform fixed amount per property*
3) *If a municipality opts in terms of subsection (2) to determine a uniform fixed amount per property falling within a specific category, such fixed amount may not exceed a prescribed percentage of the amount due for*

*rates payable on a property in that category with a market value equal to the prescribed market level.*

Rates on site value or improvement value only are disallowed. Some local government practitioners are of the opinion that this implies only one tax rate. This can be debated, as the Bill is silent on the issue of raising rates on the improved value of the property by means of separate tariffs for land and improvements. It possibly merely implies that the rate may either be a rate based on the improved value of property or a flat rate for property within a specific valuation band, provided the band is below a prescribed valuation limit. Legal opinion will have to be sought on whether separate rates for land and/or buildings can be implemented with the proviso that the combined value of the land and buildings must adhere to the improved market value principle. The principle of valuation bands seems to be a variation of the property rates system currently followed in England. Flat rates would accordingly only apply to areas where valuations are at the lower end of the scale.

To be able to raise these taxes the local authority must put a Rates Policy in place and adopt by-laws to give effect to its Rates Policy.

Although the gist of the rates policy stayed the same as prescribed by previous drafts of the Act (Local Government Property Rates Act, 2004), riders drawing attention to the plight of the poor have been added. This again places a limit on the amount of rates a municipality can raise against a property effectively as the economic well being of the property owner has to be taken into account. If he /she cannot afford to pay, the necessary relief policies need to be in place.

This section of the Local government Property Rates Act, 2004 reads as follows:

*Section 3 - Adoption and contents of rates policy*

1) *The council of a municipality must adopt a policy consistent with this Act on the levying of rates on rateable property in the municipality.*

An additional section has been added to the Bill (Local Government: Property Rates Act, 2004. Of importance is the following:

*Section 16 – Constitutionally impermissible rates*

*1) In terms of section 229(2)(a) of the constitution, a municipality may not exercise its power to levy rates on property in a way that would materially and unreasonably prejudice -*

*a) National economic policies;*

*b) Economic activities across its boundaries; or*

*c) The national mobility of goods, services, capital or labour.*

*Section 17 – Other impermissible rates*

*1) A municipality may not levy a rate –*

*(a) On the first 30% of the market value of public service infrastructure*

*(h) On the first R 15,000 of the market value of a property assigned in the valuation roll or supplementary valuation roll of a municipality to a category determined by the municipality –*

*(i) for residential properties; or*

*(ii) for properties used for multiple purposes, provided one or more components of the property are used for residential purposes; or*

*3) The Minister, acting with the concurrence of the Minister of Finance, may from time to time by notice in the Gazette, increase the monetary threshold referred to in subsection (1)(h) to reflect inflation.*

*4) The Minister may, by notice in the Gazette, lower the percentage referred to in subsection (1)(a), but only after consultation with –*

*(a) relevant Cabinet members responsible for the various aspects of public service infrastructure;*

*(b) organised local government; and*

*(c) relevant public service infrastructure entities*

The amendment protects the central government and its subsidiary's from property rates to the extent that it is exempted from rates where its activities cross the municipal boundaries. This was done to protect the organisations from being over taxed or double taxed and therefore being forced to increase the price of their services.

Of great concern however is Section (17)(1)(h) of the Local Government Property Rates Act, 2004. As a start the first fifteen thousand Rands of value of residential *contravention of the permitted use of the property, as if the improvement was erected or is being used for a lawful purpose; and*

*(c) The value of the use of the property for a purpose, which is inconsistent with or in contravention of the permitted use of the property, as if the property is being used for a lawful purpose.*

*3) In determining the market value of a property the following must be disregarded for purposes of valuing the property:*

*(a) The value of any building or other immovable structure under the surface of the property which is the subject matter of any mining authorisation or mining right defined in the Minerals Act, 1991 (Act No. 50 of 1991);*

*(b) The value of any equipment or machinery which, in relation to the property concerned, is immovable property, excluding –*

*(i) a lift*

*(ii) An escalator*

*(iii) An air-conditioning plant*

*(iv) Fire extinguishing apparatus*

*(v) A water pump installation for a swimming pool or for irrigation or domestic purposes*

*(vi) Any other equipment or machinery that may be described; and*

*(c) any unregistered lease in respect of the property*

*4) In determining the market value of a property used for agricultural purposes, the value of any annual crops or growing timber on the property that have not yet been harvested as at the date of valuation must be disregarded for purposes of valuing the property.*

*5) Where the available market related data is not sufficient to determine the market value of public infrastructure, such public service infrastructure may be valued in accordance with any other method of valuation as prescribed*

It must be noted here that there is a difference in emphasis in what is defined as market value for local government purposes against what is generally accepted in the financial world. Outside local government "Fair Value" or market value is defined as the most advantageous price realistically obtainable by a seller from a buyer who is reasonably informed about the nature and characteristics of the asset (IAS16). Open market value in the local government sense is defined as the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arms length transaction (GAMAP 102).

The effect of this difference is that local government market value is normally lower than "Fair Market Value" as defined by the IAS.

The Municipal Systems Act (Municipal Systems Act No. 32 of 2000) under Section 11, Executive and legislative authority, authorises the imposing and recovering of rates, taxes, levies, duties, service fees and surcharge on fees, including setting and implementing tariff, rates and tax and debt collection policies. This authority is now further supported by the Local government Property Rates Act, 2004.

In the past property tax has been implemented differently by local authorities in the provinces. In KwaZulu Natal, South Africa property tax was based on the Natal Ordinance No 25 of 1974, which stated that:

> *Section 151(1)*
> *Rates may be assessed and levied on immovable property as a whole, or the land and buildings may be treated as separately rateable, in which case the rate may be diversely assessed and levied, or the rate may be assessed and levied in respect of land alone.*

In the old Transvaal local authorities were allowed to raise taxes against land and buildings separately. Each of these had its own advantages to the municipalities falling under their respective Provinces' legislation. Local authorities had the freedom to choose which combination of value they wanted to use. This was normally fixed over a long period of time.

## 4.3 Discretionary Nature of Property Rates

Current legislation in South Africa only regulates the method on which property rate calculations are based. The actual determination of the rate or rate tariff is done by each council individually through a council resolution (Section 14 of the Local Government Property Rates Act, 2004).

*Section 14 – Promulgation of resolutions levying rates*

1) *A rate is levied by a municipality by resolution passed by the municipal council with a supporting vote of a majority of its members.*
2) *A resolution levying rates in a municipality must be promulgated by publishing the resolution in the Provincial Gazette.*
3) *Whenever a municipality passes a resolution in terms of subsection (1), the municipal manager must, without delay -*
    a) *Conspicuously display for a period of at least 30 days –*
        *(i) At the municipality's head and satellite offices and libraries; and*
        *(ii) If the municipality has an official web site or a web site available to it as envisaged in section 21B of the Municipal Systems Act, on that web site; and*
    b) *Advertise in the media a notice stating that -*
        *(i) that a resolution levying a rate on property has been passed by the council; and*
        *(ii) the resolution is available at the municipality's head and satellite offices and libraries for public inspection during office hours and, if the municipality has an official web-site or a web-site available to it, that the resolution is also available on that web-site.*

Central government through the Department of Finance however has the power to limit the increase in the rate tariff by setting maximum increase percentages. The local authority however, through proper justification, can exceed this set percentage with approval from the Department of Finance (Local Government Property Rates Act, 2004 Section 20).

Section 20 – Limits on annual increase of rates

1) *The Minister may, with the concurrence of the Minister of Finance and by notice in the Gazette, set an upper limit on the percentage by which rates on properties or a rate on a specific category of properties may be increased.*
2) *Different limits may be set in terms of subsection (1) for –*
   a) *Different kinds of municipalities which may, for the purposes of this section, be defined in the notice either in relation to categories or types of municipality within the meaning of the Municipal Structures Act or in any other way; or*
   b) *Different categories of properties subject to section 19.*
3) *The minister may, on written application by a municipality, and on good cause exempt a municipality from a limit set in terms of subsection (1).*
4) *This section must be read with section 43 of the Municipal Finance Management Act.*

The spending of the revenue generated by property taxation is fully at the discretion of the local authority and central government does not control it in any way whatsoever except that a local authority must have a balanced budget.

## 4.4 Application

Dale and McLaughlin (1999) pointed out that property tax is a mechanism that can be used to reduce demand for land in areas of over development or to stimulate demand – for instance by encouraging vacant or under-utilised land to be brought onto market. By taxing only land value the owner is encouraged to develop the property to its full potential as the improvements on the land are not taxed. For example, a vacant parcel of land situated within a municipality would attract property taxes based on its market value.

**Table 4.1 Vacant Land**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0500 | 5,000 | 5.00% |

Should the owner now develop this land by placing a luxury residential or other building of say R 200,000 there upon, his situation will change to the following:

**Table 4.2 Land Value Only**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0500 | 5,000 | 5.00% |
| Improvements | 200,000 | Not rateable | Nil | Nil |
| | | | | |
| Total | 300,000 | | 5,000 | 1.67% |

Clearly it is economically much more advantageous for the owner to develop the property to its fullest potential. Netzer (1998) supports this when he writes that advocates of land value taxation are arguing that taxing land alone is more favourable to investment and growth than taxing land and buildings. Bird and Slack (2004) also states that property tax is one fiscal instrument that local governments use to influence land use patterns, especially in urban areas.

With a system taxing both land and improvements the local authority can determine through the level of taxation on each, land and buildings, whether it wants to encourage or slow down development in a certain area. The table below shows the effect when land and buildings are taxed equally.

**Table 4.3 Land and Improvements Taxed Equally**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0250 | 2,500 | 2.50% |
| Improvement | 200,000 | 0.0250 | 5,000 | 2.50% |
| | | | | |
| Total | 300,000 | 0.0500 | 7,500 | 2.50% |

Should the owner decide to place improvements on the property of 300,000 his property tax will change as follows:

**Table 4.4 Land and Improvements Taxed Equally (High Improvements)**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0250 | 2,500 | 2.50% |
| Improvements | 300,000 | 0.0250 | 7,500 | 2.50% |
| | | | | |
| Total | 400,000 | | 10,000 | 2.50% |

The following table shows the effect when land is taxed higher than improvements on the original improvement value of 200,000 and therefore stimulating the development of the property to its fullest potential.

**Table 4.5 Land Tax Rate Higher Than Improvements**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0450 | 4,500 | 4.50% |
| Improvements | 200,000 | 0.0150 | 3,000 | 1.50% |
| | | | | |
| Total | 300,000 | | 7,500 | 2.50% |

Should the owner decide to place improvements on the property of 300,000 under a tax configuration where improvements are taxed at a lower rate than land, his property tax will change as follows:

**Table 4.6 Land Tax Rate Higher Than Improvements (High Improvements)**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0450 | 4,500 | 4.50% |
| Improvements | 300,000 | 0.0150 | 4,500 | 1.50% |
| | | | | |
| Total | 400,000 | | 9,000 | 2.25% |

Now compare the table below where due to dense development in a certain area the local authority, through property tax, is discouraging further development in that specific area.

**Table 4.7 Land Tax Rate Lower Than Improvements**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0150 | 1,500 | 1.50% |
| Improvements | 200,000 | 0.0300 | 6,000 | 3.00% |
| | | | | |
| Total | 300,000 | | 7,500 | 2.50% |

Should the owner decide to place improvements on the property of 300,000 under a tax configuration where improvements are taxed at a higher rate than land, his property tax will change as follows:

**Table 4.8 Land Tax Rate Lower Than Improvements (High Improvements)**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0150 | 1,500 | 1.50% |
| Improvements | 300,000 | 0.0300 | 9,000 | 3.00% |
| | | | | |
| Total | 400,000 | | 10,500 | 2.63% |

The new revised Property Rates Act (Local Government Property Rates Act, 2004) impacts on the above example negatively in the sense that at least the first R 15 000 of property valuation is exempted from rates. It is unclear at this point in time whether a local authority will still be allowed to utilise different rates on land and improvements or not. The effect would however be that the rates income will be lower than before and the local authority will be forced to increase its rates tariff to make good the loss in revenue. As mentioned before, small local authorities will especially feel the impact of this where average property values are low. Alternatively new sources of revenue will have to be found and implemented.

When using the earlier example of an equal rate for land and improvements the rate income will look as follows:

**Table 4.9 Property Rates With Exemption Applied**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0250 | 2,500 | 2.50% |
| Improvement | 200,000 | 0.0250 | 5,000 | 2.50% |
| Less Exemption | | 15,000 @ 0.0250 | (375) | (2.50)% |
| Total | 300,000 | | 7,125 | 2.375% |

To make up this lost revenue from property rates alone the local authority will be forced to increase its rate tariffs by 5.2632%. After such an increase, which is over and above normal inflation the above table will change as follows:

**Table 4.10 Increase in Property Rates to Cover the Exemption**

| Description | Value | Rate | Annual amount payable | Amount payable as % of value |
|---|---|---|---|---|
| Land | 100,000 | 0.0263158 | 2,631.58 | 2.63% |
| Improvement | 200,000 | 0.0263158 | 5,263.16 | 2.63% |
| Less Exemption | | 15,000 @ 0.0263158 | (394.74) | (2.63)% |
| | | | | |
| Total | 300,000 | | 7,500 | 2.50% |

This increase to make up for loss revenue however defeats the goal of the legislation in that the exemption of the first 15,000 of property value from rates was to provide relief for the poor. If local government cannot find alternative sources of income to make good the loss, the poor will receive little or no benefit from the proposed legislation.

## 4.5 Conclusion

Property rates are a major source of revenue for urban local government in South Africa. The Local Government Property Rates Act, 2004 has the aim to establish a uniform system of regulation and lays down the parameters that are necessary to avoid double taxation of some national services and activities, which stretches across municipal boundaries.

Property rates will be calculated on the improved value of the property as a whole. The first fifteen thousand Rands of the property value are exempt from rates. The Minister may however increase this amount. The purpose of the exemption is to provide relief measures for the poor. A specific local authority can in terms of its own indigent policy have a higher amount as tax exempt than the prescribed minimum amount.

The loss of revenue due to exemptions will have to be made good from either increased property rates or finding new and innovative revenue sources to tap into. The increase in the property rates tariff should not be an option as it defeats the purpose of the exemption in the first place, namely relief for the poor.

# CHAPTER FIVE

# LOCAL GOVERNMENT TAX LEGISLATION IN AUSTRALIA, CANADA AND ENGLAND AND THE IMPLEMENTATION THEREOF

## 5.1 Introduction

Local government tax legislation is normally very prescriptive and it is therefore important to understand the legislation as applied in each country. Each country has its own legislation and applies it differently. However the rudimentary basis of property being taxed based on market value stands throughout. This understanding will enable the reader to make comparisons and to identify best practises, which could be beneficial to local government in South Africa. Examples of some of these best practises are given where the concept differs from the normal run of the mill property tax principle.

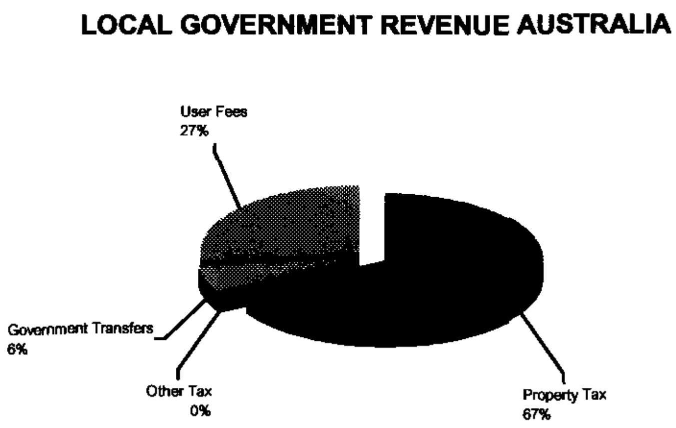
## 5.2 Australian Legislation

### 5.2.1 Introduction

The Local Government Act (Local Government Act No. 11 of 1989) regulates municipal affairs in Australia. Local government is empowered by the aforementioned Act to raise taxes and fees as revenue from which it can cover expenditure incurred, to fulfil its responsibilities to the inhabitants of its area.

From the legislation it is clear that local government in Australia also provides utility services as part of its services portfolio. This is on par with South African local government but different from England and Canada where utilities are privatised. The following chart depicts the composition of local government income in Australia.

**Chart 5.1 Local Government Revenue Australia**




## 5.2.2 Legislation

Section 111 of the Local Government Act (Act No. 11 of 1989) provides local government with the power to make local laws with respect to any act, matter or thing in respect of which the council has a function or power under this or any other Act. With this authority to make a local law, Section 113 of the same Act states that:

1. *A local law may -*
   a) *Provide that a Council may by resolution determine a fee, charge, fare or rent in relation to any property, undertaking, goods, service or other act, matter or thing; and*
   b) *Prescribe, regulate or determine the purposes for which and the conditions on which a Council may -*
      I. *Grant a permit, license, authority or registration; or*
      II. *Perform or supply a service; or*
      III. *Supply any goods or information; and*
   c) *Prescribe the manner in which an application may be made for a permit, license, authority or registration; and*
   d) *Prescribe the fee which is payable for the granting, renewal or transfer of a permit, license, authority or registration.*

2. *The power to make a local law imposing fees may be exercised by providing for all or any of the following matters -*
    a) *Specific fees*
    b) *Maximum or minimum fees;*
    c) *Maximum and minimum fees;*
    d) *Scales of fees according to the value of goods or services provided for the fees or the project being assessed;*
    e) *The payment of fees either generally or under specified conditions or in specified circumstances;*
    f) *The reduction, waiver or refund, in whole or in part, of the fees.*

Councils may use the site value, net annual value or capital improved value system of valuation as basis for determining property rates.

Some differences in terminology need to be clarified before the application of property tax in Australia can be logically discussed. Firstly, the term "land value" in the Australian concept means the improved value of the land, except where exclusions are clearly specified. Secondly, "site value" refers to the value of the land excluding any improvements made. (Land Valuation Act, 1960).

Capital improved value on the other hand carries the definition as the sum which land, if it were held for an estate in fee simple unencumbered by any lease, mortgage or other charge, might be expected to realise at the time of valuation if offered for sale on any reasonable terms and conditions which a genuine seller might in ordinary circumstances be expected to require. (Land Valuation Act, 1960).

The liability to pay rates and charges is clearly set out in Section 156 of the Local Government Act (Act No. 11 of 1989) and covers a wide selection of people:

1. *The owner of land is liable to pay rates and charges on that land;*
2. *If the owner cannot be found or identified, the occupier of, or the mortgagee in possession of, the land is liable to pay the rates and charges;*

3. *If there is a person who is the private occupier or lessee of the land and the land is land on which rates and charges could not be declared if there were no such occupier or lessee, that person is liable to pay the rates and charges;*
4. *A person who has a license to pasture any animals on Crown land under the Forests Act 1958, the Land Act 1958 or the Water Act 1989, is liable to pay the rates and charges on that land as if it was rateable land;*
5. *A person who has or should have a license under the Land Act 1958 in respect of any unused roads or water frontages is liable to pay rates and charges on that land as if it is rateable land;*
6. *A rate or charge which is declared in relation to land and is unpaid and any unpaid interest on such rate or charge and any costs awarded to a Council by a court or in any proceedings in relation to such a rate or charge or interest are a first charge on the land.*

When declaring general rates council's in Australia may declare a uniform rate under Section 160 of the Local Government Act (Act No. 11 of 1989).

> *If a council declares that general rates will be raised by the application of a uniform rate-*
>
> a) *The council must specify a percentage as the uniform rate; and*
> b) *The general rate for any rateable land is to be determined by multiplying the value of the land (as determined under the valuation system used by the council) by that percentage;*

Section 161 of the Act (Local Government Act No. 11 of 1989) specifies the requirements when a council decides to raise general rates by applying a differential rate -

1. *A council may raise any general rates by the application of a differential rate if -*
   a) *It uses the capital improved system of valuing land; and*
   b) *It considers that the different rate will contribute to the equitable and efficient carrying out of its functions.*

*2. If a council declares a differential rate for any land, the council must -*

*a) Specify the objectives of the differential rate, which must be consistent with the equitable and efficient carrying out of the council's functions and must include the following -*

*I. A definition of the types or classes of land which are subject to the rate and a statement of the reasons for the use and level or that rate in relation to those types or classes of land;*

*II. An identification of the types or classes of land which are subject to the rate in respect of the uses, geographic location (other than location on the basis of whether or not the land is within a specific ward in the council's municipal district) and planning scheme zoning of the land and the types of buildings situated on it and any other criteria relevant to the rate.*

*III. If there has been a change in the valuation system, any provision for relief from a rate for certain land to ease the transition for that land; and*

*b) Specify the characteristics of the land, which are the criteria for declaring the differential rate.*

*3. A Council, which declares a differential rate, must ensure that copies of the following information are available for public inspection at the council office -*

*a) Repealed.*

*b) The objective of the differential rate and the criteria on the basis of which that rate was declared.*

*c) The rate and amount of rates payable in relation to land in each category of differential rating and what proportion of the total rates and charges this represents.*

*d) Any other information, which the council considers it necessary to make available.*

*4. Repealed.*

*5. The highest differential rate in a municipal district must be no more than 4 times the lowest differential rate in the municipal district.*

Also of interest is that the legislation provides for incentives for prompt payment.

*Section 168.*

1) *At the meeting at which a council declares any rates or charges, the council may declare that incentives are to be given by it for the payment of those rates and charges before the due date and must include in the declaration details of the circumstances in which an incentive will be given.*
2) *A notice requiring payment of a rate or charge must specify any incentives.*

### 5.2.3 Application

Although each province has its own local government legislation the principle stays the same with only a few differences such as the frequency of valuations, whether land only or land and improvements are used in calculating the property tax. Most of the local authorities also have a minimum tax in place.

Valuation frequencies range from one to two years. Of particular interest here is the format used in Queensland, Australia. Properties are valued yearly but for property tax purposes the average of the last three valuations is used to calculate property tax. (Queensland Local Government Act, 1993). This average valuation softens fluctuations in the property market value and the resultant property tax. The following table illustrates the average valuation method.

**Table 5.1 Average Valuation Method**

| **Average Valuation Method** | | | |
|---|---|---|---|
| **Year** | **Valuation** | **Rate** | **Property tax** |
| 01 | 90,000 | | |
| 02 | 95,000 | | |
| 03 | 93,000 | | |
| Three Year Average | 92,667 | 0,006884 | 637.92 |

In the event that, due to extreme market conditions, property values rise out of proportion in a specific year, the averaging method will soften the blow to the ratepayer. The following tables show the effect of such extreme rise under the averaging method as well on property tax calculated on a single year's valuation.

**Table 5.2 Averaging Valuation Method (Market Fluctuation)**

| Year | Valuation | Rate | Property tax |
|---|---|---|---|
| 01 | 90,000 | | |
| 02 | 95,000 | | |
| 03 | 93,000 | | |
| 04 | 115,000 | | |
| Three year average | 101,000 | 0,006884 | 695.28 |

As can be seen in the above table a 23,66% increase in property value for year four, with a constant tax rate, only brought an 8,99% increase in tax payable by the owner of a property.

**Table 5. 3 Single Year Valuation Method**

| Year | Valuation | Rate | Property tax |
|---|---|---|---|
| 03 | 93,000 | 0,006884 | 640.21 |
| 04 | 115,000 | 0,006884 | 791.66 |

As can be seen from the above, under the single year valuation method, the increase of tax payable runs to 23,66%. As the rise in market values during period 04 may be a temporary phenomenon, this peak would have been softened substantially by the average valuation method.

When the current valuation is less than the average rateable valuation the current valuation will be used. (Queensland Local Government Act, 1993). Therefore giving the benefit of a lower valuation directly to the taxpayer.

Most Australian local authorities have a minimum property tax in place. This means that when the actual calculated property tax for a specific property is less than the set minimum amount the owner will be paying the set minimum amount. However when the actual calculated property tax is higher than the set minimum the calculated tax becomes payable. The principle of whichever is the highest is followed.

The purpose of a minimum rate is to increase the rates payable by lower valued properties and reduce the rates payable by higher valued properties. This however partially defeats the objective of a fair taxation. Historically property value was used as a measurement of income and wealth and therefore ratepayers in high value properties should have a greater ability-to-pay than the taxpayer in low value properties. The following is an example where a minimum rate amount is applied.

**Table 5.4 Minimum Rate Amount**

| Property Value | Tax Rate | Calculated Tax | Minimum Tax | Tax Payable |
|---|---|---|---|---|
| 50,000 | 0.006448 | 322.40 | 450.00 | 450.00 |
| 100,000 | 0.006448 | 644.80 | 450.00 | 644.80 |

As can be seen from the above table the owner of a property of low value should only have paid $322.40 property tax but due to the minimum tax is now paying $450.00. Up front this looks like unfair taxation but after an in-depth look into local government taxation it makes sense. The placing of a minimum tax shows its value in circumstances where the property valuations are low due to market and other socio-economic forces and does not reflect the real or replacement value of the property. This is especially true of properties lying in an underdeveloped area and plagued by criminal activity. Although the market values of these properties are low, they still receive the same level and amount of services and facilities from the municipality as higher valued properties. Therefore it is only fair that they (the lower value properties) contribute at least the base level of property tax needed by the local authority. Hence the setting of a minimum amount of tax.

## 5.2.4 Conclusion

Australian local government taxation is based on the market value of the property. Just like property tax internationally, it is calculated by multiplying the rate set by the council with the value of the property. Local government in Australia relies on property tax to fund 67% of its total revenue. A very high percentage measured by any standard.

Of specific importance for this study is the setting of minimum taxation. This ensures that low valued properties, still contribute to the rates revenue pool at a level representing the services they are receiving from the local authority and not at their market value. The second important factor is the custom in Queensland to use the average valuation over three years to base property tax on. This method clearly provides more stable revenue as extreme property market fluctuations are eased out by this method.

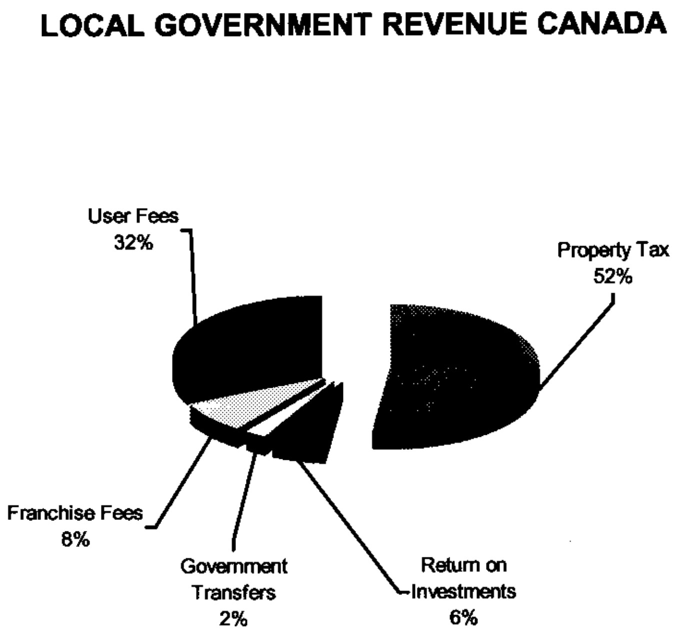
## 5.3 Canadian Legislation

### 5.3.1 Introduction

Municipal taxation in Alberta, Canada is regulated by the Municipal Government Act, Chapter M-26 of 1994. Each province has its own set of legislation and although they are all similar in regulating property tax, the Alberta legislation is of specific interest. The Act allows municipalities to raise revenue through various forms of taxation. One of which is property tax, but it also allows other forms of taxation, which forms a large portion of the revenue raised by local authorities in Canada. This is of importance as an analysis of published financial statements of Canadian local authorities shows a similar downward trend in Government transfers and subsidies as can be found in South Africa. This downward trend makes other revenue sources that much more important for the financial stability of local government.

From the offset the reader must bear in mind the fact that municipal service utilities in Canada such as water, electricity and natural gas are delivered by privatised utility companies. These companies are in most cases subsidiaries of the municipality or to a lesser extent independent economic entities, which operate solely for financial gain. Local government revenue in Canada can, on average be categorised as follows:

**Chart 5.2 Local Government Revenue in Canada**




The fact that utility revenue is divorced from local government revenue created the necessity for municipalities to also utilise other forms of revenue to finance the normal spectrum of municipal services. To utilise additional sources through taxation the Municipal Government Act (MGA M-26, 1994) was written in such a format as to allow alternative revenue resources such as Franchise fees and or linear tax.

## 5.3.2 Legislation

The Municipal Government Act (MGA M-26, 1994) defines the purpose of a municipality as:

i) To provide good government.

ii) To provide services, facilities or other things that in the opinion of council, are necessary or desirable for all or a part of the municipality.

iii) To develop and maintain safe and viable communities.

To be able to provide these services the council needs financial resources. The Act (MGA M-26, 1994) provides the municipality with the means to raise and collect taxes as a revenue source.

In order to understand these taxation revenue sources it is of the utmost importance to be clear what types of taxation the Municipal Government Act (MGA M-26, 1994) allows.

### 5.3.3 Application

The first major source of taxation revenue is property tax. Part 9; section 285 of the Municipal Government Act (MGA M-26, 1994) stipulates that a municipality must prepare an assessment for each property every year. A qualified assessor appointed by the municipality (Section 289 of MGA M-26, 1994) must do this assessment.

Starting in 2005, assessments in Ontario Canada will be based on average values from successive tax years (referred to as rolling averages). For 2005, a two-year average will be employed (a property's assessment will be the average of the current value for the tax year plus the current value for the previous tax year). For 2006 and subsequent years, property assessments will be based on three year averages. (Bird and Slack, 2004). This is similar to the system followed in Queensland Australia.

The properties within the municipality's area of jurisdiction must, according to section 297 of the Act (MGA M-26, 1994) be assigned one or more of the following assessment classes;

- i) Class 1 – Residential.
- ii) Class 2 - Non-residential.
- iii) Class 3 - Farmland.
- iv) Class 4 - Machinery and equipment.

The assessment is based on market value of the property. The assessed market value includes both the values of the land and the improvements there upon.

With the market value as base, a tax rate for each class of property is calculated. To estimate market value in a consistent and fair manner for residential properties, most municipalities use the sales comparison approach. This approach is widely accepted as the best approach to estimate market value for residential properties due to the large number of sales. This assessment is done annually. All properties are re-assessed/re-valued to stay on par with current market values.

What does the sales comparison approach entail? Property characteristics are compared for homes that have sold in order to determine which characteristics are important, and the extent they are important, in explaining sale price. Assessments are then estimated for all properties based on those that have sold.

Section 355 of the Act (MGA M-26, 1994) determines that a tax rate is calculated by dividing the amount of revenue required, by the total assessment of all property on which that tax rate is to be imposed. The amount of tax to be imposed in respect of a property is calculated by multiplying the assessment for the property by the tax rate to be imposed on that property (Section 356 of MGA M-26, 1994). Property rates are calculated on the improved value of the property. This includes land and buildings.

Of great importance here is that before the calculated tax rate can be applied, each council must pass an annual property tax bylaw. The authority to pass bylaws is found in Section 7 of the Act (MGA M-26, 1994), which allows a council to pass bylaws for municipal purposes. Section 181 of the Act (MGA M-26, 1994) sets out the requirements for a valid bylaw resolution as a bylaw or resolution of a council is not valid unless passed at a council meeting held in public at which there is a quorum present.

To meet this requirement a tax bylaw needs to be passed by council. Section 353 of the Act (MGA M-26, 1994) authorises the council to impose a tax in respect of property in the municipality to raise revenue to be used toward the payment of expenditures and transfers as set out in the budget of the municipality. After passing the bylaw on property taxes a tax notice must be sent to each property owner. The tax rates set out in the property tax bylaw may not be changed after the notices have been sent out (Section 354 of MGA M-26, 1994).

The local authority, by law (School Act, SA 1998, Chapter S – 3.1) is required to collect education taxes for schools. The amount to be collected is determined by provincial government through the property tax system. The total levy is distributed amongst all rateable properties based on the assessed value of the property. Decisions on how education funds will be spent lies with provincial government and not with the local authority. Non – residential properties contribute at a higher rate than residential properties. The education tax is shown separately on the tax bills to clearly identify tax, which the local authority has control over, and tax that is imposed by external or higher authorities.

To illustrate the tax raised by a typical city the following table is given.

**Legend**

**Mun. Rate =** Municipal Rate | **Mun Tax =** Municipal Tax

**Education Rate =**Educational Rate | **Education Tax =** Educational Tax

**Table 5.5. Tax Raised (Canada)**

| | Taxable Assess 000,000 | Mun Rate | Education Rate | Mun Tax 000 | Education Tax 000 | Total Tax 000 |
|---|---|---|---|---|---|---|
| Single Res. | 53,540 | 0.0043935 | 0.0045789 | 235,227 | 245,154 | 480,381 |
| Farm Land | 3 | 0.0087949 | 0.0045789 | 26 | 14 | 40 |
| Multi Res. | 3,073 | 0.0043935 | 0.0045789 | 13,501 | 14,071 | 27,572 |
| Non – Res. | 18,737 | 0.0137995 | 0.0067074 | 258,561 | 125,677 | 384,238 |
| M & E | 0 | 0 | 0 | 0 | 0 | 0 |
| | | | | | | |
| **TOTAL** | **75,353** | | | **507,315** | **384,916** | **892,231** |

Applying the above tariffs to an average single residential unit the results will be as follows:

**Table 5.6. Average Residential Tax (Canada)**

| | Taxable Assess | Mun Rate | Education Rate | Mun Tax | Education Tax | Total Tax |
|---|---|---|---|---|---|---|
| Single Res. | 200,000 | 0.0043935 | 0.0045789 | 878.70 | 915.78 | 1,794.48 |

## 5.3.4 Other Taxes

### 5.3.4.1 General Taxes

Of particular interest is that in Alberta, Canada, municipal taxation is not limited to property tax only. Section 8 of the Municipal Government Act (MGA M-26, 1994) allows council to pass bylaws that provide for a system of licences permits or approvals including any or all of the following:

> *Establishing fees for licences, permits and approvals that may be in the nature of a reasonable tax for the activity authorised or for the purpose of raising revenue.*

Section 61 of the Act (MGA M-26, 1994) further strengthens this authority by allowing a municipality to:

*i)* *Grant rights, exclusive or otherwise, with respect to its property, including property under the direction, control and management of the municipality.*

*ii)* *A municipality may charge fees, tolls and charges for the use of its property, including property under the direction, control and management of the municipality.*

This opens the opportunity to tap into other revenue sources. One of these sources emanates from charging royalties/franchise fees or linear tax to telephone, natural gas, electricity and oil companies for their right to distribute and sell their services/commodities to clients situated within the municipality's area of jurisdiction.

accordance to set procedures. The Alberta Linear Property Assessment Manual (2002) sets out the standards and procedures.

Using the street lighting component of electric power systems as an example the following illustrates the calculation of linear tax for this component:

Base Cost = n X rate per pole and represents the value of the infrastructural unit.

Where n = the number of poles in the city.

Let's assume that there are 1000 poles in the municipal area and a base rate of $80.00 per pole is applied.

Base Cost = 1 000 X $ 80
= 80,000

The base cost is then multiplied by the tax rate set by the local authority to determine the linear tax payable.

## 5.3.4.3 Tax Agreements

An agreement according to a specific bylaw is set up with each company clearly setting out the rules, regulations and amounts payable by the company to the local authority. A municipal council may make a tax agreement with an assessed person or company who occupies or manages -

- The municipality's property, including property under the direction, control and management of the municipality.
- A non-profit organisation.

Similarly Section 360 of the Municipal Government Act (MGA M-26, 1994) allows a council to make a tax agreement with the operator of a public utility or of linear property who occupies the municipality's property, including property under the direction, control and management of the municipality.

It, the MGA (1994), further stipulates that a tax agreement must provide that the municipality accepts payment of the amount calculated under the agreement in place of the taxes and other fees or charges specified in the agreement.

Such agreements normally take the form of a fixed yearly amount or a percentage of gross revenue in the case of public utilities. It also stipulates a guaranteed minimum amount payable and/or a percentage of turnover, whichever is the greatest.

### 5.3.4.4 Government Grants In Place Of Taxes

A municipality may apply to government for a grant if there is a property in the municipality that the government has an interest in. The government on the other hand may pay the municipality a grant not exceeding the amount that would be recoverable by the municipality if the said property were subject to property Tax (Section 366 of MGA M-26, 1994).

This allows government the choice to pay or not to pay as well as stretching the payment to a date of its choice without incurring interest or penalties. The municipality is also left powerless, as it has no grounds to institute legal action against government for not paying. This is due to the fact that the payment of such grant is solely at the discretion of government.

### 5.3.4.5 Petitioning/Special Tax

Groups of people or communities within the tax area of the municipality are also allowed to, under certain conditions to petition council to raise additional taxes against properties owned by individuals in that community. This is normally done to raise funds for specific community projects such as community halls, arenas and recreation areas. The municipality will then, if approved, fund the project and after the fact recover the costs from the property owners. The recovery will take place over a period of time. This form of special tax is fair to the other communities who do not share in the benefits provided by the specific project.

### 5.3.5 Tariff Determination

The property tax rate or mill rate to be published as a bylaw is determined once a year during the annual budget process. Each year council approves the amount of revenue required to support city services. From this amount other sources of revenue, such as grants, license fees, business taxes and user fees are subtracted. The balance is the total amount to be raised by property taxes. This total required is divided amongst all property owners based on the assessed value of their property type. Tax rates are developed for residential, non-residential and farmland assessment classes. The tax levy is calculated by multiplying the individual assessment by the tax rate.

### 5.3.6 Collection

Section 208 of the Act (MGA M-26, 1994) determines that the Chief Executive Officer must ensure that the revenues of the municipality are collected in a manner as directed by council. The collection process of municipal tax is supported in the Act (MGA M-26, 1994) by section 344, which allows council to pass a bylaw to impose penalties at a rate as specified in the bylaw for late payment.

Taxes due to a municipality are an amount owing to the municipality and are recoverable as a debt. This recoverable debt takes priority over the claims of every person except the Crown and is a special lien (Section 352 of MGA M-26, 1994). Of definitive interest is section 553 (1) of the Act (MGA M-26, 1994), which reads as follows:

> *" A council may add the following amounts to the tax roll of a parcel of land:*

a) *Unpaid costs relating to service connections of a public utility that are owing by the owner of the parcel.*
b) *Unpaid charges for a municipal utility service provided to the parcel by a municipal utility that are owing by the owner of the parcel.*
c) *Unpaid expenses and costs if the parcel's owner contravened the enactment or bylaw and the contravention occurred on all or part of the parcel.*
d) *Costs associated with the tax recovery proceedings related to the parcel.*

The above section allows for the recovery of service arrears as a tax with the advantage of declaring the debt as a preferential recoverable debt. Subsequent only to debt recoverable by the Crown.

The Municipal Government Act (MGA M-26, 1994 Section 41) also, in accordance with its bylaws allows a municipality, for any lawful reason to:

a) *Discontinue providing an municipal utility service after giving reasonable notice of its intention to do so, and*
b) *Remove the system or works of the municipal public utility used to provide the utility service.*

The non-payment of a municipal utility constitutes such a lawful reason after reasonable notice has been given.

When payment regarding tax is received, the payment must first be applied to tax arrears before the current year's tax can be redeemed (Section 343 of MGA M-26, 1994).

Property belonging to the Crown is generally exempt from property tax. Section 366 Of the Act (MGA M-26, 1994) allows a municipality to, on a yearly basis, apply to the Crown for a grant not exceeding the amount that would be recoverable by the municipality if the property that the Crown has an interest in were not exempt from taxation.

### 5.3.7 Conclusion

Property tax in Canada is based on the total improved value or market value of the property. Valuations take place on a yearly basis. In addition to property tax the owner is also taxed with an education tax. The local authority has no control over the educational tax rate and pays the full amount over to the Education Board. Of specific interest are the following:

**Linear Property tax** - Infrastructure runs on or under municipal property rendering it unsuitable for further development. Utility companies are using this asset to generate business revenue and are therefore required to pay tax for the use of this municipal asset.

**Tax agreements** - Agreements are negotiated between the utility company and the local authority to pay a percentage of turnover to the municipality in lieu of taxes and other fees. Such an agreement normally stipulates a guaranteed minimum amount payable.

**Government Grants** - Although government property is exempted from property tax the municipality can apply to government for a grant equal to the amount of what property taxes would have been should the property be rated.

**Special Tax** - The municipality can raise a special tax against a group of properties to finance development which will benefit those properties. The overwhelming majority of affected property owners must have been in favour of such development and tax. Such development and special tax request normally comes from the property owners and not the municipality.

The tax base is therefore a lot broader than just conventional property tax.

## 5.4 British Legislation

### 5.4.1 Introduction

Local Government in England is charged with the promotion of well being of their communities by the Local Government Act (Act 2000 Chapter 22). Section 2 of the Act (Local Government Act, 2000, Chapter 22) sets out the local authority's powers for this promotion of well being as follows:

*2) Promotion of well-being*

1. *Every local authority are to have power to do anything which they consider is likely to achieve any one or more of the following objects:*
    a) *The promotion or improvement of the economic well being of their area.*
    b) *The promotion or improvement of the social well being of their area.*
    c) *The promotion and improvement of the environmental well being of their area.*
2. *The power under subsection (1) may be exercised in relation to or for the event of -*
    a) *The whole or any part of a local authority's area, or*
    b) *All or any persons resident or present in a local authority's area.*
3. *In determining whether or how to exercise the power under subsection (1) a local authority must have regard to their strategy under section 4.*
4. *The power under subsection (1) includes power for a local authority to -*
    a) *Incur expenditure.*
    b) *Give financial assistance to any person.*
    c) *Enter into arrangements or agreements with any person.*
    d) *Co-operate with or facilitate or co-ordinate the activities of any person.*

e) *Exercise on behalf of any person any function of that person, and*
f) *Provide staff, goods, services or accommodation to any person.*

To be able to fulfil its obligations a local authority must generate financial resources as a means to pay for the services provided to the area. These resources are gathered through council and other taxes levied upon the residents in the local authority's area as well as other external sources such as government grants. At this point it needs to be clearly stated that utilities are privatised and do not fall under local government. Education and social services however form part of the local authority's responsibilities.

### 5.4.2 Council Tax

Council tax in England has over the years evolved dramatically to what it is today. In 1939 property rates was instituted. This taxation was based on the site value, which was determined as follows:

> *The annual site value of a land unit shall be the annual rent which the land comprising the land unit might be expected to realise if demised with vacant possession at the valuation date in the open market by a willing lessor upon a perpetually renewable tenure upon the assumptions that date -*
>
> a) *They were not upon or in that land unit -*
>     I. *Any buildings, erections or works except roads; and*
>     II. *Anything growing except grass heather gorse sedge or other natural growth.*
> b) *The annual rent had been computed without taking into account value of any tillage's or manure's or any improvements for which any sum would by law or custom be payable to an outgoing tenant of a holding.*
> c) *The land unit free from any encumbrances except such of the following encumbrances as would be binding upon a purchaser - (London Rating Bill, 1938 - 1939).*

However, these assessments became unrealistic due to infrequent valuations. The lack of regular valuations took place notwithstanding the fact that Central Government bears the cost of re-valuations. The property tax system was replaced in 1990 with a community charge (poll tax) system, which operated on a flat rate per head basis. On April 01, 1993 the community charge was replaced by the council tax system. Council tax combines the features of the earlier tax systems.

The amount of council tax payable on a property depends primarily upon the valuation band to which it is allocated. There are eight bands in England; the lowest - Band A - is for dwellings worth less than £ 40 000 on April 1991 and the highest -

-Band H - is for those more than £ 320 000 on that date. The banding system makes tax bills predictable and stable. The following table shows the full banding system.

**Table 5.7 Valuation Bands (England)**

| Valuation Band | Range of Values | Proportion of Band D |
|---|---|---|
| A | Up to and including £ 40,000 | 6 |
| B | £ 40,001 - £ 52,000 | 7 |
| C | £ 52,001 - £ 68,000 | 8 |
| D | £ 68,001 - £ 88,000 | 9 |
| E | £ 88,001 - £ 120,000 | 11 |
| F | £ 120,001 - £ 160,000 | 13 |
| G | £ 160,000 - £ 320,000 | 15 |
| H | More than £ 320,000 | 18 |

Band D is the specified band for calculating council tax. For other bands, the tax is calculated by using the proportions specified by Government (for example, band A is set at six ninths of band D and band H is set at 18 ninths of band D). For the 2003/2004-tax year the council tax payable was set as follows:

**Table 5.8 Council Tax (England)**

| Band | Council Tax |
|---|---|
| A | 494.40 |
| B | 576.81 |
| C | 659.21 |
| D | 741.61 |
| E | 906.41 |
| F | 1071.22 |
| G | 1236.01 |
| H | 1483.22 |

As an example a residential property with an improved value of £ 100,000 with two adults and two children under the age of 18 is taken to demonstrate the council tax payable for a particular year. With a value of £ 100,000 this property falls within band E. The council tax payable as read from the above table amounts to £ 906.41 per year less the applicable rebates. In the example used no rebates will be applicable.

However, if the example was changed to one adult and two children under the age of 18 the payable council tax will change as follows:

| | |
|---|---|
| *Band E* | *906.41* |
| *Less: Discount (25%)* | *226.60* |
| Council Tax Payable | 679.81 |

The following rebates are available to taxpayers that qualify -

1. A 50% discount is awarded if the dwelling is not occupied as a sole or main residence of any person, e.g. empty properties or second homes.
2. A 25% discount is awarded if there is only one resident aged 18 or over.
3. A 25% discount is awarded where there is more than one resident, and all but one is "disregarded persons" for the purposes of the council tax.

Council tax is the sole responsibility of the owner of the property. The general rule is that the person(s) over 18 whom is solely or mainly resident and has the greatest legal interest in the home has to pay. This generally means that is the highest of the following list has to pay:

- Resident freeholder(s) or owner-occupier.
- Resident leaseholder(s) with a lease/tenancy of 6 months or more.
- Resident secure or statutory tenant(s). This includes council tenants.
- Resident licensee or any other resident.
- If there are no residents, the responsibility passes to the owner. This is the person(s) with the freehold or leasehold of the dwelling.

A 25% discount in council tax bill is given to dwellings where only one adult lives, whereas second and empty homes are eligible for a 50% discount. The amount to be paid is set by local authorities according to a prescribed formula; taking as reference two adults in an £ 80 000 house (Band D), those in a £ 30,000 house (Band A) will pay two-thirds as much tax, and those in a Band H house, twice as much. The income from rates is collected by the local authority and then paid into a central pool and is then redistributed to local authorities on the basis of population. (Inland Revenue Valuation Office - Income from Council Taxes). Charges and fees are retained locally.

Advantages of the council tax are -

- Administration is relatively easy.
- Ensuring compliance is straightforward; the taxes are difficult to evade or avoid.
- Because the taxes are tied to the property, they can be localised and be applied to any form of local government structure.

Disadvantages of council tax -

- The tax is regressive in that an undue proportion of the overall burden is borne by occupiers of lower-value properties.

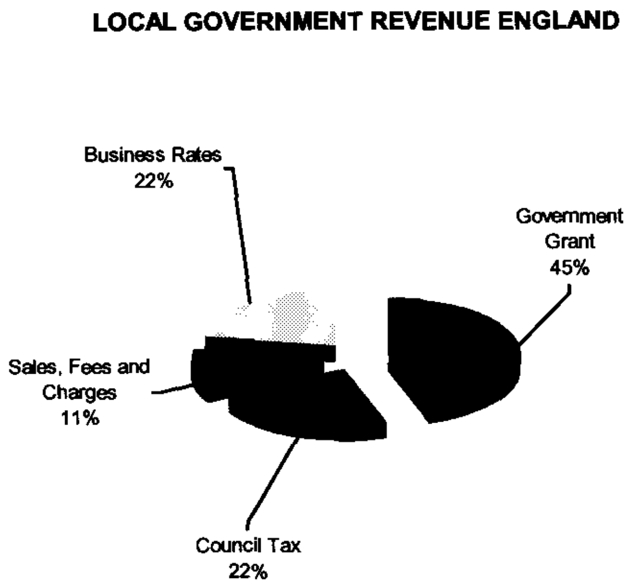
- The tax is also regressive across local authorities, with the lowest rates in England in Westminster, where some of the most expensive properties in England are situated.
- The lack of provision for a revaluation means that values are diverging from the original 1991 assessments. Bird and Slack (2004) notes that the next revaluation is currently scheduled for 2007 (To be based on 2005 values). This is true of whole areas, of property banding within areas, and of individual properties within bands.
- Banding avoids valuation of individual properties, and leads to fortuitous advantages and disadvantages for those with properties whose value is close to the step from one band to the next. As a result, the initial valuation generated almost a million appeals and it is likely that this would happen again if the values were revised.
- The tax generates insufficient income; £ 9.8 billion was collected in 1996, as against £ 30 billion if the domestic rates had continued and were still a similar portion of revenue. This shortfall has had to be made good by increases in other taxes, notably VAT. (http://www.landvaluetax.org/flvtprps.htm) [Accessed November 19, 2002].

Local authorities must fulfil their duties as prescribed by the Local Government Act (Local Government Act, 2000, Chapter 22) from revenue received out of council tax and other sources of revenue. The total resources of local governments are made up out of:

a) Council Tax plus.
b) Grants from Central Government determined by formulae made up by the Department of Transport and Local Government to share out the pool of Uniform Business Rate (UBR is assessed locally, with the "poundage rate" set by central government, collected locally and sent to central government for redistribution). The basis of share-out is nominally on a per capita basis, but the measure of "social need" varies from council to council.
c) Other grants for specific purposes.

On average the revenue by source available to local government in England is as shown in the chart below (According to Modernising Local Government Finance: A Green Paper) The revenue figures obtained from local governments during the study confirm these ratios with only small differences.

**Chart 5.3 Local Government Revenue England**




The Council collects business rates on behalf of the Government. The Government then pays back to the Council an amount based on population. The 22%, as shown in Chart 5.3 represent only the portion that is received back from central government.

Government Grants can be divided into two main categories namely a Revenue Support Grant, which is given to all local authorities to support their general spending on services. Other grants received are project or service specific.

Local authorities set their budget and council tax. They have to balance their spending priorities against their internal sources (council tax), the grant from government and what they will be permitted to borrow. The key decision is what services and facilities local people want and what level of council tax they are prepared to pay. In order to protect local people from excessive council tax increases, the government has reserve powers to cap budget increases.

Local authorities in England are reliant on central government for funding a large portion of their expenditure. This is clear from the fact that on average 45% of revenue comes from government grants.

### 5.4.3 Land Value Taxation Campaign

At present there is a campaign in England to reform council tax back to land value based taxation. In summary the Campaign advocates:

1. *The replacement of the Council Tax and the Uniform Business Rate by a property tax based on site values only; all land, including vacant and agricultural land would be assessed for the tax, and the assessment would be on the assumption that the land was at its optimum permitted use within the constraints of planning regulations.*

2. *Within a given taxation area, the rate of tax should be the same for land in all classes of use.*

3. *The tax would be multi - part, with elements set by central government, the local authority and any other tier of government, which may be established under devolution proposals. For that part of local government finance where service provision is to a national standard and local authorities are, in effect, acting in the status of agencies on behalf of central government, it is suggested that they should be fully funded from the national element of the site value rate; examples include police and fire services, education and social services.*

4. *It would be desirable to revise valuation lists annually. In most cases this would not require inspection of individual sites since much of the work*

*would be amenable to statistic adjustment. Provision should be made for major quinquennial revaluations though experience with annual reviews may show that these are unnecessary.*

*The Campaign is of the view that the proposed variation in income tax in Scotland is not a satisfactory means of providing a Scottish Parliament with tax raising powers. Any tax raised by a Scottish Parliament should take the form of a tax on Scottish land values. It is suggested that consideration be given to empowering the Scottish Parliament to raise revenue from a uniform rate on land value in Scotland against compensating reductions in personal income tax and other forms of general taxation.* (http://www.landvaluetax.org/flvtppprps.htm) *[Accessed November 19, 2002].*

## 5.4.4 Conclusion

Property tax in England is not purely based on the market value of the property. All property is classified into valuation bands. Actual valuation of the properties has not taken place in a number of years. A tax is determined for each band and, irrespective of the actual market value of the property, applied to all properties in that band.

As can be seen from the revenue distribution figures the major revenue source for municipalities is government grants. This is due to the fact that central government responsibilities such as housing and social services have been moved down to local government. Together with the responsibilities came the transfer of revenue to local government to fund these services.

The local council also collects business tax on behalf of central and provincial government. The total amount is paid over to central government and a portion is the received back later.

There is a current pressure group lobbying to change council tax away from the band system to a system where current market value forms the base for property tax calculations.

## 5.5 Summary

With the exception of England, which uses bands, all the target countries use market value as base for their property tax calculations. Basic principles are the same and the property owner is taxed on the value of his property.

As can be seen from the discussions on the different countries no particular country has a distinct overall advantage over any of the others through their particular property tax system. It is rather a case of each one of the countries having one or two unique applications that proves to be beneficial for them, the local authority and the property owners. Some examples are the average valuation system and minimum tax used in Australia, the linear tax system and tax agreements used in Canada and in England the there is the large proportion of revenue received from central government.

In the next chapter these unique best practises are applied to the current legislation and practise in South Africa in an attempt to get to property tax legislation and practise that encompasses the best of all four countries.

# CHAPTER SIX

# APPLYING THE AUSTRALIAN, CANADIAN AND BRITISH MODELS TO THE SOUTH AFRICAN SCENARIO.

## 6.1 Introduction

Local authorities in South Africa, as their counterparts internationally, generate the bulk of their revenue through property tax. It is therefore a fundamental source of income for local government services in most developed and developing countries. The revenue from property tax is discretionary revenue and is used to fund services that benefit the community as a whole.

Community needs however exceed the financial resources currently available. A local authority needs to generate more revenue to try and provide for the needs and demands of the voters. The increase of rates raised from the same group of property owners is not always an option because the tax threshold will soon be reached. The tax threshold is that level where a property owner would rather sell his property and move away than continue to pay the level of property tax imposed upon him.

Currently it is only the property owners, whether residential, commercial or industrial who pay the bill. The other inhabitants of the city are not directly affected by property tax. Property tax or at least a portion thereof can be passed on to the tenant through property rentals. However, a market related rental threshold also exists. There still remains a number of services and infrastructure the tenants enjoy but do not contribute to. This should be taxed though a form of indirect tax.

The increased demand from the ratepayers on the financial resources of the local authority necessitates increased income to pay for the additional services. Natural growth of the city certainly assists in the creation of additional revenue but is by far not sufficient. Alternative ways to increase revenue from municipal taxation needs to be developed. The purpose of this study is to address some of these alternatives.

## 6.2 Reliance on Property Tax as Main Revenue Source

By analysing the revenue distribution trend in the four target countries the following were found:

**Table 6.1 International Revenue Distribution Percentages**

| Country | Property Tax | Other Municipal Tax | Government Grants | Sales & Services |
|---|---|---|---|---|
| Australia | 67,00% | 0,00% | 6,00% | 27,00% |
| Canada | 47,00% | 3,00% | 15,00% | 35,00% |
| England | 15,00% | 21,00% | 45,00% | 19,00% |
| South Africa | 28,00% | 0,00% | 4,00% | 68,00% |
| | | | | |
| Average | 39,25% | 6,00% | 17,50% | 37,25% |

In comparing the straight average of the four target counties combined it is clear that three of the results obtained are outside the norm. These are the high reliance England places on government subsidies, the high reliance South Africa places on revenue generated from the sales of services and the high reliance Australia places on revenue generated from property tax.

Dependence on property taxes as a source of local government revenue varies however from jurisdiction to jurisdiction depending on factors such as the expenditure responsibilities assigned to local government, other revenue available to them, and their willingness and ability to enforce such taxes. (Bird and Slack, 2004).

Also clear from the above table is the fact that South Africa is under utilising prospective revenue sources such as other taxation and government aid. Both of these areas will be addressed later on in this chapter.

## 6.3 Valuation Base

There are three principal approaches to the assessment of property taxes. They are rental value, capital value and market value. Under the rental value principle, the tax is based on the average gross rental income the property is expected to generate under prevailing market conditions.

The capital value principle on the other hand determines that the capital value can be estimated on the basis of rental values. Rental values under this principle are treated as earnings on capital.

Generally Accepted Municipal Accounting Practice (GAMAP 102) defines "Open Market Value" as the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a willing seller in an arm's length transaction. The difference between this and fair market value has been explained previously.

To estimate market value in a consistent and fair manner for residential properties, most municipalities in Canada use the sales comparison approach. This approach is widely accepted as the best approach to estimate market value due to the large number of sales.

Under the sales comparison approach, property characteristics are compared for homes that sold in order to determine which characteristics are important and to what extent they are important in explaining the sales price. A number of factors such as supply and demand, community and surroundings and physical attributes have an influence on the market value of the property. Assessments are then estimated for all the properties based on those that have sold. Under circumstances where valuations are done yearly this is the most cost-effective approach.

The data collected for this study also have shown that, in the target countries, property tax is based on the market value of the property. The market value of the property is taken as the improved value of the property, which includes land, buildings and any legal rights on that property. The proposed property tax legislation for South Africa also determines that property value must be based on the improved market value of the property.

In a simple rural economy property value and taxation may provide a fairly good indicator of both ability to pay and benefits received from public services. In South Africa where selected sections of the community have received homes from the government, this argument may not hold true. Due to unemployment these property owners cannot afford to pay taxes.

At stake here is the question whether it is fair to tax property as an indicator of wealth rather than linking the level of property tax to the level of services provided in that area.

Basing taxes on a one-year only valuation may leave the local authority and or the ratepayer open to unreasonable fluctuations due to the volatility of the property market. The market may be at a high due to external factors such as the settlement of a new large industry and the housing need it creates at the time of valuation. Market values will be high due to the shortage in available properties. A simple question of the demand temporarily exceeding the supply. Shortly thereafter supply may catch up with the demand and market values will again normalise.

Fair and productive property taxes require not only a good initial assessment but also periodic revaluation to reflect the changes in value. Frequent valuations maintain the legitimacy of the tax and reduce the risk of sudden dramatic shifts in the tax burdens from large increases in assessed values. For these reasons the valuation cycle must be fairly short. (Bird and Slack, 2004).

The system followed in Queensland, Australia provides an equalising factor by using a three-year average of yearly evaluations as base for property tax calculations. The properties are still valued yearly but for property tax purposes the average of at least three valuations is used to calculate property tax. In the event that, due to extreme market conditions, property values rise out of proportion in a specific year, the averaging method will soften the blow to the ratepayer. The system however also provides that when the current valuation is less than the average rateable valuation, the current valuation will be used.

The three-year average system also has its difficulties although it is useful in times of generally increasing valuations. In the 80's Australia experienced substantial declines in commercial property values in the central business districts. The three-year average would have been problematical, as it would have held values at a higher level where the commercial owners could not have afforded the rates based on their occupancies.

A similar average valuation system will start in 2005 in Ontario Canada where assessments will be based on average values from successive years. (Bird and Slack, 2004)

## 6.4 Frequency of Valuations

Despite outdated valuation rolls in many many municipalities, rates have increased significantly in the past few financial years. As a result of not having the true market value of these properties, the municipality simply adjusts the actual rating percentage or the rating factor to realise the amount required for the rates component of the budget.

In the past, properties in South Africa were valued at least once in five years but could be done more frequently with a maximum of once per year. The Local Government Property Rates Act of 2004 now requires valuations to take place at least once in four years. This shortening in valuation cycle through legislation serves to support the theory that frequent valuations are needed. Internationally the trend on property valuation frequency shows a variance between one and three years. Interim valuations, both internationally and in South Africa, are done as and when needed. This need normally arises when a property is sold or new improvements to the property are completed.

Both Canada and Australia follow the principle of yearly valuation. England on the other hand has not had actual valuations done since 1991. The lack of regular valuations in England took place notwithstanding the fact that central government bears the cost of valuations.

The danger of infrequent valuations is that the property values, on which property rates are based, become outdated and therefore do not reflect the owner's ability to pay. It also has the effect that council has to increase its rates to keep up with inflation and other factors such as the need for new or improved infrastructure. Frequent valuations will maintain the legitimacy of the tax and reduce the risk of sudden shifts in tax burdens (Bird and Slack, 2004).

Theoretically the ideal situation would be to have all properties physically valued on a yearly basis to ensure the currency of valuations. This is however not only impractical from a time perspective but also cost prohibitive. Therefore the valuation method implemented in Canada whereby the sales comparison approach is followed and the value of each property mathematically determined is recommended. This method is not only cost effective but also inductive to reasonably accurate yearly valuations.

Municipal functionaries contacted agreed that the ideal situation would be to have a yearly valuation done. However practically the costs of such an endeavour would be prohibitive. The costs would be too high in relation to the revenue advantage gained.

To achieve the goal of yearly valuations on a cost-effective basis the sales comparison approach should be followed as valuation method for residential properties. In the case of commercial and industrial properties the same approach can be used with the difference that rental values are used to compare properties.

As previously mentioned property values can fluctuate outside what is reasonably expected. The ideal property valuation frequency would therefore be on a yearly basis but with the proviso that the three-year average method should be used to flatten the peaks in the property market.

## 6.5 Tax Exemptions

It may be desirable to have a set of tax exemptions in place to provide relief for the poor or the aged. Care must however be taken not to have too many exemptions in place as it erodes the tax base to the extent where the rate has to be increased to make good the revenue lost through exemptions. Alternatively new and innovative revenue sources will have to be developed.

All local governments have some sort of tax exemptions, which are aimed at certain groups or sectors in the community. The local authority is normally authorised by legislation to make exemptions but the prerogative lies with the individual municipalities to decide if, how much and to whom exemptions will be given. Thus the local authority can control the effect of the exemptions on its revenue base.

Of great concern is Section (17)(1)(h) of the Local Government Property Rates Act, 2004. This section exempts all residential properties from paying property tax on the first R15,000 of property value. This amount is determined by the Minister and can
be increased by him. This may lead to the amount becoming a political tool in that the amount can later be set at such a level that certain sections of the community will be exempt from tax while others will be taxed more heavily to make up the lost revenue.

Local Government practitioners interviewed on this issue support the principle of exempting a portion of the value from property rates. They however feel strongly that each local authority should be allowed to determine their own exemption amount. This can be done logically after considering unique local circumstances and the current economic climate.

## 6.6 Minimum Property Tax

Only Australia out of the four target countries applies this principle. Minimum tax in Australia means that when the actual calculated property tax for a specific property is less than a set minimum amount, the owner will be paying the set minimum amount. However when the actual calculated property tax is higher than the set minimum amount the calculated tax becomes payable.

The purpose of a minimum tax rate is to increase the rates payable by lower valued properties and reduce the rates payable by higher valued properties. This however, somewhat defeats the objective of fair taxation. Normally property value is used as an indicator of the owner's ability to pay. In South Africa property value in certain communities surely does not indicate the ability to pay anymore.

Minimum tax shows its value in circumstances where the property valuations are unnaturally low due to market and other socio-economic forces and does not reflect the real replacement values of the property. It is only fair that the lower valued properties contribute at least the base level of property tax needed by the local authorities. All other properties must then make good the difference between the base level and the actual cost of services.

## 6.7 Tax Bands

Section 11(2) of the Local Government Property Rates Act, 2004 allows for a flat rate for property within a specific valuation level, provided that the valuation level is below a prescribed valuation limit. Subsection (3) of the same Bill states that if a municipality opted in terms of subsection (2) to determine a uniform fixed amount per property, falling within a specific category, such fixed amount may not exceed a prescribed percentage of the amount due for rates on a property in that category with a market value equal to the prescribed valuation level.

Out of the four target countries only England uses the Band system to determine property rates payable. The tax in England is rather called council tax due to the fact that the properties have not been valued since 1991 and therefore does not reflect market value of the properties.

The principle of a valuation band as set out in the Local Government Property Rates Bill, 2003 seems to be a variation of the system currently followed in England. The English system makes tax bill predictable and stable. The rate determined for each band serves as base rate from which tax and rebates are calculated. Banding avoids valuation of individual properties and leads to unreasonable advantages and disadvantages for those with properties whose value is close to the step from one band to the next.

Irrespective whether a banding system is used or not it is pertinent that properties be valued on a regular basis as to ensure that the property is placed in the correct band.

On the issue of flat rates within a certain band. Flat rates would accordingly only apply to areas where valuations are at the lower end of the scale. This flat rate can very easily be related to the minimum tax principle as applied in Australia and discussed earlier.

## 6.8 Linear Tax

Although the distinction is ambiguous, most writers define direct taxes as those, which are imposed initially on the individual or household that is meant to bear the burden. Indirect taxes are taxes which are imposed at some other point in the system but are meant to be shifted to whomever is supposed to be the final bearer of the burden (Musgrave and Musgrave, 1989). Linear tax is clearly falling under the definition of indirect tax and the effect thereof is passed to the users of the services taxed.

Canada is the only one of the four target countries to implement linear tax. The principle stems from the infrastructure needed or used to provide selected services. The infrastructure runs on or under municipal land and the companies are using this land and infrastructure to generate profitable business. The use of council controlled or owned property (assets) by utility companies should attract cost just as the use of any other commercial asset would. Therefore the use of the asset (infrastructure) is taxed.

Base values of the different components of infrastructure are determined by a central organisation and these base values then applied to the actual infrastructure in place. This is done to ensure a nation wide standard to protect the utility companies from over taxation by one particular local authority. The base value of an asset can relate to the acquisition cost or construction cost of that asset but on a countrywide average. A linear tax rate is determined by the local authority and applied to the base values determined for the actual infrastructure.

These assets or linear property can be described as electric power systems, street lighting, and telecommunication systems and pipelines used for the gathering, distribution or transportation of a commodity. This definition specifically excludes land and buildings as they are taxed under normal property tax principles. Signals travelling through the air are excluded from linear tax but transmitters and repeating stations are subject to linear tax.

The extent to which cities utilise the opportunity to raise linear tax also varies due to the size of the city in relation to the level of infrastructure in place. It is logic that a utility company will be willing to pay tax at a higher rate when the consumer base is large. This allows them to redistribute the tax burden over a larger number of consumers

Local government in South Africa currently makes use of cross subsidisation of property tax from the sale of services. The cross subsidisation is done by means of an arbitrarily determined percentage of sales. It is normally based on electricity sales. This leads to great debate from the electrical engineers that the amount is not properly based and should be much smaller. They, the electrical engineers, would like to see the cross subsidisation eliminated.

A 10% cross subsidisation towards property tax was the acceptable norm for South Africa. The principle behind cross subsidisation is sound. In a highly populated area, users of municipal services who do not necessarily own property in the municipal area also contribute towards those services for which no direct user fees are charged. This spreads a portion of the tax burden over a broader basis. The cross subsidisation can also be seen as a form of indirect tax levied by the municipality.

Linear tax as applied in Canada provides a good and explainable base from which calculations can be done to determine cross-subsidisation of property tax. In the situation where utilities such as electricity are privatised, the implementation of linear tax will guarantee a continuous flow of revenue to support the local authority and the services it must provide.

## 6.9 Tax Agreements

Another phenomena only found in Canada out of the four target countries. The Municipal Government Act of 1994 allows a city to draft and enter into tax agreements with companies in place of taxes, fees or charges. Tax agreements normally take the form of a minimum amount guaranteed and or a percentage of turnover whichever amount are the greatest. This implies that in a normal or bad economic climate the city is guaranteed a minimum tax income from that company. In a good economic year where turnover exceeds the norm the city will receive proportionally more property tax.

## 6.10 Government Properties

In all the target countries, government properties are exempt from taxation or at least subject to tax limitations. In Canada however legislation (Municipal Government Act, Chapter M-26 of 1994) allows local government to apply to central government for a grant if there is a property in the municipality that the government has an interest in. The central government may pay the municipality a grant not exceeding the amount that would be recoverable if the property was taxed under normal conditions.

## 6.11 Financial Modelling Of Best Practises On To the South African Scenario

### 6.11.1 Assumptions

To logically build a financial model it is necessary to make a number of assumptions, which will be applied throughout the model. With these crucial elements, such as number of properties etc. staying constant the effect of other variables such as tax exemptions will become clearer. These assumptions are set out in ***Appendix 2***. Due

to the large number of properties in a local authority it was necessary to place property valued into bands and use the top value in each band as the rateable value of a properties falling into that band.

### 6.11.2 Financial Modelling

#### 6.11.2.1 Base

Each local authority needs a calculated amount financed out of property tax. This is needed to provide services to its inhabitants for whom specific user fees are not charged or the fees charges are at sub-economical level. This revenue is obtained by rating all properties. The rate is determined by multiplying the value for each property with the tax rate as determined by council. All the results added together provide the local authority with its property tax income.

The first step in the process is to create a base level of tax from which the process can originate. The base as shown in ***Appendix 3*** will stay constant as additional factors are added to the equation. In the table one can clearly see the revenue generated from each property band and type. Also shown is the effect of cross subsidisation from utilities (mainly electricity). Total tax revenue therefore comes to R 109,349,000. Add to this the revenue generated from government grants and the sale of services (water and electricity) and our model local authority has total revenue of R 379,549,000.

It is on this base revenue that we will apply to the other factors such as exemptions, grants on government properties, minimum tax and linear tax.

### 6.11.2.2 Tax Exemptions

The Local Government Property Rates Act, 2004 Section 15(2)(e) stipulates that rates are disallowed on the first fifteen thousand Rands of value of all residential properties. As previously stated this exemption will have a negative effect on the revenue generated from property tax. The financial effect of the exemption on the base model is shown in ***Appendix 4.***

In the model, the local authority will lose R 13,050,000 (R 109,349,000 - R 96,299,000) in tax revenue. Under the current financial conditions this 11.934% loss of revenue cannot be absorbed as the budgets have already been cut to the minimum to afford the most services at the lowest cost to the people. It has to recover this loss in revenue in order to balance its books. The only way is to increase tariffs to make good the loss.

Albeit that a tariff increase is not well accepted by the public, the local authority needs to increase its rates tariff by 17.126% to make good the loss. The effect of this increase is shown in ***Appendix 5.***

The effect of the increase lessens the advantage property owners on the lower end of the valuation scale received but still leaves them on a lower level than calculated on the base model. Property owners on the top end of the scale on the other hand are paying 8.342% more than on the base model. This still concurs with the government policy of providing relief for the poor by redistributing wealth.

### 6.11.2.3 Grants On Government Properties

Traditionally, all government properties were excluded from the property tax net. With government however now prescribing certain exemptions from property rates for the general owners of residential properties it is only fair to expect government to assist local government in making good the resultant loss of revenue. One avenue of doing this is by providing a local authority with a grant equal to what property rates would have been if government properties were rated under normal circumstances.

***Appendix 6*** shows the result should this be implemented. The additional revenue is not enough to make good the full extent of the exemptions but assists to some extent. Council can therefore again partially lower the property tax rate to equalise the additional revenue. In the model the addition of this revenue source has a resultant 2.21% decrease in the general rate (***Appendix 7***). A welcome relief for the general property owner.

### 6.11.2.4 Minimum Tax

The purpose of a minimum tax rate is to increase the rates payable by lower valued properties and reduce the rates payable by higher valued properties. The principle is that lower valued properties should contribute at least the base level of property tax needed by the local authority to provide basic services in the community. By applying a set minimum tax (still lower than the original base tax) additional income is generated as shown in ***Appendix 8.*** Again this generates additional revenue, which is still part of the process to claw back the revenue lost through the government-determined exemptions.

As with grants on government properties the revenue gained through minimum tax should be ploughed back into the rates tariff structure. This can still not be seen as additional tax revenue as the current tax rate is still higher than in the base model. ***Appendix 9*** shows that a further 1,22% decrease in the rate is possible.

### 6.11.2.5 Linear Tax

By implementing the Canadian system of linear tax as shown in ***Appendix 10*** additional revenue is gained but revenue previously available through cross subsidisation is now lost. This stems from the principle of fairness by not double taxing a source. Thus the local authority loses R 20,000,000 in cross subsidy but gains R 26,621,600 in linear tax.

The revenue gain R 6,621,600 is however still not enough to make good the initial loss suffered through the government imposed exemptions as shown in ***Appendix 11*** The revenue is once again applied to lowering the tax rate in an effort to obtain the original level of taxation as shown in the base model. A further drop of 8,12% in the tax rate is however feasible.

### 6.11.3 Summary

The financial model takes us from an original tax rate of 0.0870 cents in the Rand to a high of 0.1019 cents in the Rand after implementation of government-imposed exemptions. An increase in the tax rates of 17,126% without taking into account any inflationary pressures. By implementing the suggested measures such as minimum tax, grants on government properties and linear tax the local authority can be in a position to lower the rate from the high of 0.1019 cents in the Rand to 0.0911 cents in the Rand.

In real terms the local authority clawed back an estimated R 11,754,000 of the original loss of R 13,050,000 suffered through central government intervention in local government affairs. Government policy can therefore be implemented with only a 4,7% increase in property rates needed to fund such policy.

The proposed measures can however not be implemented under the current legislation in South Africa and legislation changes will be necessary.

## 6.12 Conclusion

Property taxation should be based on the market value of the property. This market value must be re-assessed on a yearly basis to ensure it is keeping pace with current market conditions. Market conditions can however be very volatile in certain areas and need to be equalised to protect the property owner from sudden shifts. Applying the three-year average valuation system can achieve this.

The revenue potential of a specific area is severely reduced by tax exemptions to be applied to that area. This even more so increases the pressure to find additional revenue sources. One such source is linear or indirect tax. The tax is raised at one point and then passed down to the end user of the service or goods. This has the advantage that it is not only the property owner contributing to tax revenue but all individuals living in that area.

The financial model shows the effect of applying the unique best practises to the current scenario in South Africa. It clearly shows the benefit for local government and the taxpayer to have these practices implemented.

# CHAPTER SEVEN

# IDENTIFYING POSSIBLE AMENDMENTS NEEDED TO SOUTH AFRICAN LEGISLATION

## 7.1 Introduction

The current property tax legislation as well as the Local Government Property Rates Act, 2004 in South Africa do not accommodate all the recommendations mentioned in Chapter 6. Amendments will have to be made to the legislation to enable local government to tap into these resources.

The amendments to legislation must be of a general nature so as to enable local government to, while adhering to the principle of the legislation, adapt the application thereof to fit in with their unique local conditions. A simple example of this is the R15 000 minimum exemption from tax. The influence thereof on a small municipality is more dramatic than on a large city where property valuations are high.

The rest of this chapter will attempt to clarify and propose amendments to the current legislation and bills. Local government through their representative bodies should push central government into changing legislation at local government's soonest convenience.

## 7.2 Tax Exemptions

Property Tax legislation in all four of the countries makes provision for tax relief or tax exemptions in one or another form. This is normally written into legislation by government in an effort to provide relief for the aged and the poor. Tax exemptions erode the potential revenue from property tax and should be cautiously applied. This is supported by Bird and Slack (2004) when they state that revenues would be higher if property tax were based on the value of land and buildings, if there were few exemptions and if there were no favourable treatment of particular property classes. Sections 16 and 17 of the Local Government Property Rates Act, 2004 states as follows:

*Section 16 – Constitutionally impermissible rates*

*(1) In terms of section 229(2)(a) of the constitution, a municipality may not exercise its power to levy rates on property in a way that would materially and unreasonably prejudice -*

*a) National economic policies;*

*b) Economic activities across its boundaries; or*

*c) The national mobility of goods, services, capital or labour.*

*Section 17 – Other impermissible rates*

*(1) A municipality may not levy a rate –*

*a) On the first 30% of the market value of public service infrastructure*

*h) On the first R 15,000 of the market value of a property assigned in the valuation roll or supplementary valuation roll of a municipality to a category determined by the municipality –*

*(i) for residential properties; or*

*(ii) for properties used for multiple purposes, provided one or more components of the property are used for residential purposes; or*

*3) The Minister, acting with the concurrence of the Minister of Finance, may from time to time by notice in the Gazette, increase the monetary threshold referred to in subsection (1)(h) to reflect inflation.*

*4) The Minister may, by notice in the Gazette, lower the percentage referred to in subsection (1)(a), but only after consultation with –*

*(a) relevant Cabinet members responsible for the various aspects of public service infrastructure;*

*(b) organised local government; and*

*(c) relevant public service infrastructure entities*

Section 17(1)(h) of the above will have a devastating effect on (especially the small) local authorities where average property values are lower than in the cities. In the case of large cities the R 15 000 represents 7,5% of the total property value. In the small rural towns this percentage increases to 30%. At present the

Act (Local Government Property Rates Act, 2004) is prescriptive in setting the minimum exemption on at least R 15 000. Each local authority should be allowed to determine its own minimum exempt amount or at the very least a sliding scale should be determined.

Local authorities can be easily classified into groups by means of average property values and minimum exempt amounts determined accordingly. Unique local circumstances and economic climate must play a role in determining the exempt amount. A town with an average property valuation of say R 50 000 should surely have a lower minimum than cities with an average of R 200 000 per property. The minimum amount could be determined by placing a set percentage in place through legislation. On average, 7.5% of total average property value would, in the case of a city with an average property value of R 200 000, produce the required R 15 000. In the case of a small town (R 50 000 average valuation), it will produce a more reasonable R 3 750 exemption.

Section 17(1)(h) of the current Act should be amended to read as follows:

> *At least the first 7.5% of the average value of all residential property, provided that the Minister may, in consultation with the Minister of Finance, from time to time, increase this percentage to reflect inflation; and*

This amendment will create an exemption amount that will be fair to all local authorities irrespective of their size. The exemption will then be based purely on average property value and will also reflect a local authority's ability to recover this exemption from other sources.

A sliding scale is also a possibility to address this principle. Properties of say below a certain threshold receive a set percentage in exemption where properties above this threshold would receive a lower exemption. It may even be feasible not to provide for any exemption above a certain property value.

An exemption based on a percentage rather than a fixed amount will provide the flexibility needed to make the exemption fair to both small and large local authorities. Care must however be taken not to set the exemption percentage too high as it will then still be overly detrimental to the smaller local authority's potential revenue from property taxation.

## 7.3 Government Properties

The most recent version of the Local Government Property Rates Act, 2004 allows municipalities to rate government owned properties subject to the conditions set out in Section 16 of the Act. This would be a substantial change from previous local government legislation where government owned properties were exempt from property rates as a whole.

Now that the Act is in place local government will at least have this small portion of additional rates revenue available to them. An added advantage here above some of the other countries forming part of this study is the fact that the properties are taxable and pressure can be placed on government to pay its dues on a timely basis.

## 7.4 Minimum Property Tax

The Act to some extent leaves the door open for local government to raise a minimum property tax on certain properties. Section 11 of the local Government Property Rates Act, 2004 states the following:

> *Section 11 - Amount due for rates*
>
> *(1) A rate levied by a municipality on property must be an amount in the Rand-*
>
> a) *On the market value of the property;*
> b) *In the case of public service infrastructure, on the market value of the public service infrastructure less 30% of that value as contemplated in section17 (1)(a), or on such lower percentage as the Minister may determine in terms of section 17(4); or*
> c) *In the case of property to which section 17(1)(h) applies, on the market value of the property less the amount stated in that section,*

*or on such other amount as the Minister may determine in terms of section 17(3).*

*(2) A rate levied by a municipality on properties with a market value below a prescribed valuation level may, instead of a rate determined in subsection (1), be a uniform fixed amount per property*

*(3) If a municipality opts in terms of subsection (2) to determine a uniform fixed amount per property falling within a specific category, such fixed amount may not exceed a prescribed percentage of the amount due for rates payable on a property in that category with a market value equal to the prescribed market level.*

The flat rate implies a minimum tax, but the proviso that it may not exceed the normal amount needs to be removed for it to be effective. It does not stand to reason why a local authority would, in addition to the first R15 000 of property value being rates exempt, charge rates at a lower level than under normal circumstances.

Minimum tax has the purpose to ensure that properties on the lower end of the valuation scale at least pay a tax equal to the absolute base level of tax needed by the local authority to provide basic services. This principle is followed in Australia and should also be implemented in South Africa. It will ensure that properties, situated in the old townships, pay at least their fair share of the taxes needed by the municipality to provide basic services. It is not a good idea to keep on overtaxing the few highly valued properties while the low value properties are not at least contributing to basic services.

The specific subsection that needs amendment here is subsection (2). It should rather refer to the fact that the amount of rate should not exceed the basic amount a municipality would need from each property to provide basic municipal services. This section should be changed to read as follows:

*2) The amount of the flat rate in terms of subsection (1)(b) may not exceed the basic amount that would be needed from each property to provide basic municipal services.*

It must further be the choice of the specific local authority to levy a flat rate/minimum tax or not. One should remember that property tax is discretionary revenue and therefore a local authority should have some form of decision-making powers on the raising thereof.

## 7.5 Frequency of Valuations and Valuation Base

Section 32 (1)(b) of the Local Government Property Rates Act, 2004 ensures that all properties must be valued every four years. This Section reads as follows:

> *32(1) A Valuation roll –*
>
> *b) Remains valid for that financial year or for one or more subsequent financial years as that municipality may decide, but in total not for more than four financial years.*

The valuation of a specific year is taken and rates calculated there upon. A more reasonable approach would be to value properties on a yearly basis and then use the average method to determine the base value to calculate property tax on. Section 32 (1) should be amended to incorporate the option for the municipality to use the average method as followed in Queensland.

Section 32 (1) should be amended to read as follows:

*32(1) A Valuation roll –*

- *a) Takes effect from the start of a financial year following the completion of public inspection period required by section 49; and*
- *b) Remains valid for that financial year or for one or more subsequent financial years as that municipality may decide, but in total not for more than two financial years.*
- *2) At request of a municipality, the MEC for local government may extend the period for which a valuation roll remains valid to three financial years.*
- *3) Notwithstanding the above a municipal council may decide by resolution that, for the purpose of making and levying rates for a*

*financial year on rateable land in its area, the improved value of the land is to be its averaged value.*

4) *If Subsection (3) applies to a financial year, the averaged value of rateable land for the financial year is the lesser of –*
   a) *The land's effective value for the financial year; or*
   b) *The amount calculated as follows –*
      i) *If the land has effective values for the financial year and each of the previous 2 financial years – the average of the 3 effective values;*
      ii) *In any other case – an amount equal to the land's effective value for the financial year multiplied by the averaging factor.*
5) *In subsection (4) –*

   ***"Averaging factor",*** *for a financial year, means the number calculated, to 2 decimal places, using the formula –*

$$\frac{T}{3V}$$

*Where –*

***"T"*** *means the total of the effective values of all rateable land in the local government's area for the financial year and the previous 2 financial years.*

***"V"*** *means the effective value of all rateable land in the local government's area for the financial year.*

The above determines an averaging factor, which is applicable to the whole of the area valued. It calculates the average increase or decrease in value over all properties. It stands to reason that a single new property's value can and should be affected by market trends in the city. It is possible that a property becomes rateable for the first time during a high property value peak and therefore this peak needs to be flattened out. The averaging factor serves as basis to effect this.

The average valuation method as proposed above will soften fluctuation in the property market value and the resultant property tax. The higher frequency of the valuations will also ensure more up to date valuation information and therefore ensure the currency of the valuation roll.

## 7.6 Linear Tax

Linear tax is a form of indirect tax, which is passed down to the consumer. The principle stems from the infrastructure used to provide services. In the urban environment this infrastructure runs on or under municipal land and the companies are using this land and infrastructure to generate profitable business. Linear property can be defined as electric power systems, street lighting, telecommunication systems and pipelines used for the gathering, distribution or transportation of a commodity (MGA M-26, 1994).

A standardised base value is allocated to each type of infrastructure. The base value is then multiplied with the tax rate set by the municipality to calculate linear tax payable. The company pays the amount and then offset the expenditure through their product/service prices.

Section 16 (1) of the Local Government Property Rates Act, 2004 states that a local authority may not exercise its power to levy rates on property in a way that would materially and unreasonably prejudice –

a) *National economic policies;*
b) *Economic activities across its boundaries; or*
c) *The national mobility of goods, services, capital or labour.*

In addition to this Section 17(1)(a) of the Local Government Property Tax Act, 2004 disallows the raising of property rates on the first 30% of the market value of public service infrastructure.

The current version of the Local Government Property Tax Act, 2004 therefore allows a large portion (70%) of the value of public infrastructure to be taxed. A good base to calculate these taxes is to use linear tax. Industry may however be concerned that double taxation of public infrastructure will take place. When applying the linear tax principle as applied in Canada double taxation does not take place. It ensures that only that portion of property and services situated within a municipality's area of jurisdiction is taxed. We are thus looking at internal infrastructure and not bulk infrastructure such as main telephone lines. It is also clear that electrical distribution is not included in the above.

The plans of central government to place electricity distribution in South Africa under the control of Regional Electricity Distributors (Reds) and local government losing this source of revenue makes the change of this section of the proposed legislation that much more important. Some source of revenue must be put in place to replace the revenue lost.

Section 358(1) of the Municipal Government Act (MGA M-26, 1994) also prescribes that the tax rate to be imposed on the linear property must be uniform throughout the municipality and that the tax rate must be calculated in accordance to set procedures.

It is of great importance that a national standard must be set for the valuation of linear property. This is essential in assuring that linear property is valued on the same basis throughout the country. This ensures that all municipalities use the same basis of valuation although their linear tax rate may differ. Such standards should be set out in a set of regulations applicable to all municipalities.

The following sections should be added to the property rates legislation to facilitate the charging of linear tax.

*Section 1*

*(1) Unless subsection (2) applies, an assessment must be prepared for an improvement whether or not it is complete or capable of being used for its intended purpose.*

*(2) No assessment is to be prepared for linear property that is under construction but not completed on or before June 30, unless it is capable of being used for the transmission of gas, oil or electricity.*

*Section 2*

*(1) Assessments for linear property must be prepared by a designated assessor.*

*(2) Each assessment must reflect the valuation standard set out in the national regulations for linear property.*

*Section 3*

*(1) In preparing an assessment, the assessor must, in a fair and equitable manner,*

*a) Apply the valuation standards set out in the national regulations, and*

*b) Follow the procedures set out in the regulations.*

*(2) If there are no procedures set out in the regulations for preparing assessments, the assessor must take into consideration assessments of similar property that is being assessed is located.*

*Section 4*

*(1) The tax rate to be imposed on linear property must be uniform throughout a municipality.*

*(2) The tax rate to be imposed on linear property must be calculated in accordance with the procedure prescribed in the regulations.*

*Section 5*

*This section should include exclusions such as roads, waterways etc. Care must however be taken not to include internal infrastructure into this section.*

## 7.7 Tax Agreements

The Municipal Government Act of 1994 (Alberta, Canada) allows local government to enter into tax agreements with companies in place of taxes, fees or charges. These agreements normally take the form of a minimum guaranteed amount and or a percentage of turnover, whichever are the greatest. This method of taxation may find great acceptance with industry, as they then pay tax as they produce rather than having to pay a substantial amount whether they produce and sell their product/service or not.

Canadian legislation specifically only targets certain areas such as "operators of a public utility or of linear property who occupies the municipality's property, including property under the direction, control and management of the municipality" (Section 360 (1)). Non-profit organisations are included in this by Section 333 (1) of the Municipal Government Act, 1994. This can surely be extended to other organisations and businesses as well.

Care needs to be taken to ensure that local government receives, as a minimum, at least the amount it would have received under normal property tax. Allowance should be made in the Local Government Property Rates Act for this form of taxation.

## 7.8 Collections

It is important for effective property tax legislation to also provide local government with strong tools to recover taxes that were raised. To raise taxes is one thing, but to ensure that every Rand raised is paid to the municipality on a timely basis is of equal importance. Taxes due to a municipality are an amount owing to the municipality and are recoverable as a debt.

In Alberta, Canada this recoverable debt takes priority over the claims of every person except the Crown and is a special lien (Section 352 of MGA M-26, 1994). Thus giving local government the power to recover all outstanding taxes. The MGA however goes further in Section 553 of the Act (MGA M-26, 1994) allowing local government to add the following amounts to the tax roll of a parcel of land.

a) *Unpaid costs relating to service connections of a public utility that are owing by the owner of the parcel.*
b) *Unpaid charges for a municipal utility service provided to the parcel by a municipal utility that are owing by the owner of the parcel.*
c) *Unpaid expenses and costs if the parcel's owner contravened the enactment or bylaw and the contravention occurred on all or part of the parcel.*
d) *Costs associated with the tax recovery proceedings related to the parcel.*

This allows for the recovery of service arrears as a tax with the advantage of declaring the debt as a preferential recoverable debt subsequent only to debt recoverable by the Crown.

The Local Property Rates Act, 2004 is silent on the treatment of arrears rates and service charges in the collection process. This matter should be addressed in the legislation as to provide local government with the tools to effectively recover outstanding debt.

## 7.9 Differential Rates

Section 11 of the Local Government Property Rates Act, 2004 addresses the issue that the rate must be based on the improved market value of the property. It is however silent on the issue of raising rates on the improved market value of a property by means of separate tariffs for land and improvements.

With a system taxing both land and improvements the local authority can determine through the level of taxation on each, land and buildings, whether it wants to encourage or slow down development in a certain area. Past property tax legislation in South Africa allowed the raising of taxes against land and buildings separately. A tax principle that should be continued in the new legislation to give local authorities greater power to do land usage control.

## 7.10 Summary

The Local Government Property Rates Act, 2004 is providing a base from which property tax can be equalised throughout South Africa. Attention however needs to be given to certain areas of the proposed legislation to ensure the maximisation of revenue while still adhering to the fairness tax principle.

The R 15,000 of the value of a property will have a devastating effect on small local authorities. This exemption amount should rather be changed to set percentage of the valuation. This will create an equal effect for small local authorities as it does in large local authorities.

Municipalities should due to the exemption above also be allowed to raise minimum tax. This will ensure that the local authority receives at least, the base amount to cover basic services from each property.

To equalise sudden fluctuations in the property market, which affect valuation, a three-year average method of valuation should be followed.

Local government should be allowed to charge "Linear Tax" on infrastructure and land used by companies to provide services inside the municipality. This will not only generate additional revenue, but also provide a base to tax private companies taking over utilities from the municipality such as the REDS.

Local government should also be allowed, at local government's pleasure, to enter into tax agreements with business, industry and not for profit organisations in full payment of property tax or other fees payable to local government.

Not only will these amendments provide additional revenue from a broader tax base it will also enhance fairness of the tax base and principle.

The suggested amendments will have advantages and disadvantages for both the local authority and the taxpayers. It is believed that the advantages outweigh the disadvantages. A few of the advantages are:

1) Advantages for the local authority.
   a) The provision of a more stable revenue stream from property tax through using the three-year averaging method of valuation.
   b) Yearly valuations will ensure that the valuation rolls keep up with market trends.
   c) Implementation of linear tax would provide a defendable source of revenue from indirect tax.
   d) Linear tax would provide a strong base of revenue should utilities be privatised and the cross subsidisation revenue to property tax lost.
   e) Stronger tools to ensure timely payment of municipal tax and service charges.

f) Enable local government to regulate land usage more effectively.
g) Ensure that low valued properties, at minimum, pay for basic common services.
h) Create greater equality between small and large local authorities as far as the effect of tax exemptions goes.

2) Advantages for the ratepayer.
   a) The averaging method will soften the tax blow ascribed to unreasonable market fluctuations.
   b) Yearly valuations will facilitate a steady increase in property tax instead of big jumps every so many years.
   c) Exemption amounts will be directly related to property values in a particular environment.
   d) Other ratepayers will be assured that non-payers will be dealt with accordingly.
   e) Due to the tax burden being spread over a broader base of property owners and users of services, property tax rates may be lowered

Some of the disadvantages are:

1) Disadvantages for the local authority.
   a) Yearly valuations will increase the cost of preparing and updating the valuation roll.
2) Disadvantages for the ratepayer.
   a) More aggressive collection procedures.
   b) Additional tax burden through indirect tax.
   c) Low valued properties to pay a minimum tax that may be higher than the property value multiplied by the tax rate.

As can be seen there will be more advantages than disadvantages for both the local authority and the ratepayer should the legislation changes as proposed be implemented.

# CHAPTER EIGHT

# PRIORITISATION OF LOCAL GOVERNMENT EXPENDITURE AND ACCOUNTABILITY

## 8.1 Introduction

The previous chapters dealt mainly with the finding of new sources of taxation to fund the ever-increasing financial needs of local authorities. The financial plight of local governments has been accentuated in recent years by the tendency of various provincial governments to attempt to ease their financial difficulties by transferring more responsibilities (and costs) to the local level, while simultaneously reducing the rate of increase of provincial transfer payments. (Tindal C. R. and Tindal S Nobes, 1990). This increases the financial needs of the individual local authorities.

The financial needs of each local authority are different from its neighbour's due to a number of factors. Firstly, a local authority may take a conscious decision to aim for a high or a low council tax, or to give one service a higher priority than another. Such a decision would normally stem from the council's perception of what the voters expect to see. Secondly, efficiency influences costs and ultimately the level of service delivery. Thirdly, there are factors beyond the control of any individual authority such as unemployment, which has a direct influence. (Tindal and Tindal, 1990). It is also true that budgets show an increased expenditure in favour of social development and poverty relief.

The effects of population size, density and urbanisation on expenditure depend on the expenditure type. For example, a higher density may increase the demand for street and road maintenance, but low density may increase the per capita costs for schools (City Budget Manual).

Bergstrom and Goodman (1973) found evidence that when the size of a municipality reached a certain limit; the local expenditures started to rise. They also found that renters voted for more public expenditures than house owners and that people aged over 65 demanded more public services. Thus the composition of the city also influences costs. One can safely reason that the type of expenditure or priorities is directly influenced by the population configuration within the local authority.

The budget process and content will be influenced by not only the predilections of the elected representatives but also the pressures generated by various groups and individuals in the community. (Tindal and Tindal, 1990).

This explains why the budgets of local authorities differ substantially in financial terms from each other. Property tax and service charges are directly influenced by these budgets and therefore also the levels of service provided in each community.

The aims of a good local government finance system should be:

- To provide adequate funding to all local authorities.
- To promote continuous improvement.
- To provide a reasonable degree of predictability and stability.
- To balance funding for local government's delivery of national priorities and targets with real financial freedom and responsibility for local authorities.
- To be fair to those who use and pay for local authority services.
- To clarify accountability for financial decisions.
- To be intelligible and transparent to all stakeholders.

A local authority has to give attention to a number of other issues such as budget prioritisation and communication as it cannot just increase its rates and service charges to achieve these goals. Affordability is a very important factor to consider when approving the budget. Rates and service charges can be a significant cost to business and the residents, and if too high, they may relocate to another city/town where rates are more affordable. This could lead to job losses or inconvenience to residents.

## 8.2 Tax Principles

Taxes, fees and charges must be fair and should be understood by those who pay them. There should be clear accountability for the tax charge and non-domestic payers, such as industries and business, should not be subsidised by residential taxpayers. It should be the other way round as business and industry can shift that burden into their product pricing. This supports the "user pays" principle.

The ability of non-residential property owners to export taxes to residents of other jurisdiction may however require the imposition of limits on the local government's ability to determine tax rates on this class of property. The burden of non-residential property taxes is borne by the consumers of the products or services produced utilising such property to an extent depending on market conditions. If the product or service is exported outside the jurisdiction, consumers in other jurisdictions may bear part of the tax. This reduces democratic accountability because those bearing the burden of the tax are not the same as those enjoying the benefits. (Bird and Slack, 2004).

Property tax is considered regressive in nature in that it is not based on people's income but on the assessed value of their properties and does not reflect the ability to pay. It is also criticised as a slow growth tax because its base does not change in proportion to the general level of economic activity (Tindal and Tindal, 1990).

The slow growth criticism can be greatly countered by having regular evaluations done on all properties and applying those to the tax roll. This would ensure that economic activity, as far as property sales go, is reflected in the tax. As to the regressivenes of property tax one could still reason that the owner of a high value property should sell that property if he cannot pay the taxes due.

## 8.3 Budgets

### 8.3.1 Budget Processes

Budgeting and prioritisation of Local Government expenditure are among the most important responsibilities of a council. To logically fulfil this responsibility it is necessary for the councillors to understand the types of expenditure a local authority will incur as part of its operations.

Operating expenditure for local government, covers the day to day cost of running an authority and all the services it provides such as salaries and maintenance of buildings, roads etc.

The revenue side of the budget represents one half of the budget process, and it establishes how municipal operations will be funded. Unless there is good reason to believe that there will be an increase in revenues, a good practice in estimating revenue is to assume no more funds will be available next year than this year from any source. Also keep in mind that money received from a source this year may not be available next year. Each possible revenue source should be identified and analysed separately when estimating revenues to ensure the most accurate and up to date information is used. (Alaska Department of Community and Economic Development).

The amount of revenue a municipality generates limits the size of its operating budget. A municipality should not rely too heavily on outside sources of revenue because these can't be controlled as well as local revenues. (Alaska Department of Community and Economic Development).

Councils should avoid:

- Borrowing money to support general taxes.
- Over estimating revenues and under estimating expenditures.

- Agreeing to continue a service or operate a facility even though there is no revenue to support it and it cannot be made self-supporting.
- Spending all the revenues received in a year without setting aside funds for emergencies.

Capital expenditure on the other hand covers large purchases that provide benefits to the community over a long period of time, such as the cost of building a new road. Planned expenditure that is included in the municipality's capital budget will impact on the operating costs and income needed to operate the municipality's assets. This important fact needs to be brought to the council's attention so that they can grasp the full effect of their decisions.

The budget is a tool for organising information and serves as a plan for receiving and spending money. It is also a tool for explaining to the public what money is being received, how money is being spent, and what services are being provided. It is important that the budget reflects the community's goals and objectives and that the budget process allows for maximum public input (Alaska Department of Community and Economic Development).

Local authorities in general are expected to have balanced budgets. A budget is balanced when the money to be received (revenues) is greater than or equal to the money to be spent (expenditures). In a case where there is a deficit concrete decisions must be shown on how the municipality plans to cover the deficit.

The Local Government Transition Act (Act No. 209 of 1993) in Section 10 (G)(3) sets the following rules with regards to local government budgets:

a) *A municipality shall annually on or before the date determined by law, compile and by two thirds majority of all members of its council, approve a budget for-*

*i. Operating income and expenditure.*

*ii. Capital expenditure, which must reflect the source of finance, future capital charges, operating and maintenance, costs as well as the consequential influence thereof on levies, rates and service charges.*

*b) A municipality shall –*

*i. Not budget for a year – end deficit on its operating account, and*

*ii. Ensure that the budget is in accordance with its integrated development plan.*

*c) In addition to the budget referred to in paragraph (a), a municipality shall compile capital programmes including an investment programme for municipal infrastructure, having regard to the integrated development plan.*

It is all well and good that a local authority has prepared its budget according to the guide lines set by council and the provincial government but the revenue and expenditure levels needs to be controlled to ensure the affordability principle is adhered to. Section 4 (b), (c) and (d) of the same Act (Act 209 of 1993) ensures controls over the budgets of local governments by a third party.

> *b) In so far as it may be essential for the pursuit of the national economic policy, the Minister of Finance, after consultation with the Minister, may determine maximum expenditure limits for the budgets or components of such budgets of municipalities for a financial year.*
>
> *c) The budgets referred to in subsection (3)(a) shall be submitted to the Minister of Finance within 14 days from the adoption thereof by the council for the purpose of monitoring whether the expenditure limits referred to in paragraph (b) have been complied with: Provided that the Minister of Finance may delegate this monitoring function to the MEC responsible for finance.*
>
> *d) If a budget contemplated in paragraph (c) does not comply with the maximum expenditure limits referred to in paragraph (b), such budget shall be referred back to the council concerned for reconsideration and amendment thereof at the next council meeting; Provided that the Minister of Finance may exempt a particular municipality from complying with the said expenditure limits.*

One should remember that even if the local authority receives a capital grant from central government for a specific project, the day to day running of the completed project needs to be budgeted for in the operating budget (Musgrave and Musgrave, 1989). This fact is sometimes not taken into account by councils when approving projects financed out of government grants and after the completion of the project find themselves with committed operating expenses necessitating substantial increases in rates.

The traditional budget is prepared "from the bottom up", in that the process is initiated by a request from the treasurer to the various departments for an estimate of their spending requirements. The department heads are responsible for the preparation of their department's spending needs, starting with an examination of the actual expenditures of the previous year and building upon them. Thus there is a tendency to accept the level and general distribution of departmental expenditures as given, as a base from which to build. (Tindal and Tindal, 1990).

This draft budget is examined by a finance or executive committee where such exist or by the full council. For the first time councillors become aware of the mill rate (property tax rate) implications of the various expenditure requests. In most cases the increase in taxes is felt to be excessive and reductions in expenditure is required. It is still common to order a percentage decrease across the board. (Tindal and Tindal, 1990).

### 8.3.2 Alternative Approaches

Alternative approaches are needed to make these budgets more realistic and affordable to the general public. One such alternative is that the process should start with council giving some goals and objectives. Budget process needs to be extended to incorporate some analysis of existing programs and activities to demonstrate that such activities are not only consistent with municipal objectives but are performed effectively. (Tindal and Tindal, 1990).



It is a common misconception that a capital project funded by a government grant is free and should immediately be approved. They, the councillors, lose sight of the fact that the asset will have maintenance and operating costs that will only show up in the future.

The moment the project is started these operating costs become committed future expenditure, which means that future rates and tariffs must increase even before inflationary and other cost increasing factors are taken into account.

A multi-year budget approach will ensure that these future costs and their effects are clearly shown. This will make councillors and programme managers aware of the full cost implications of a project. With the full financial implications available they can then make an informed decision on the future of such project.

The following example serves as an illustration to show the importance of such multi year budgets

New road construction financed by an external loan

Capital cost R 10 million

Financed over 20 years at 0% interest

**Table 8.1 Capital Budget**

| **Project Costs** | **Year XX1** | **XX2** | **XX3** | **XX4** | **XX5** |
|---|---|---|---|---|---|
| Capital charges | 500,000 | 500,000 | 500,000 | 500,000 | 500,000 |
| Maintenance | 0 | 10,000 | 10,000 | 50,000 | 100,000 |
| Future Upgrading | 0 | 0 | 0 | 0 | 500,000 |
| | 500,000 | 510,000 | 510,000 | 550,000 | 1,100,000 |

By only seeing a one-year budget council would be oblivious to the huge increase in rates and tariffs that will be required in year XX5. As this year may coincide with an election they would surely reconsider the urgency of the new road. Additional information on hidden costs such as additional policing costs for this stretch of road must also be brought to council's attention.

The above multiple year budget approach is also supported by Mercer ET All, 1981.Some local governments prepare five-year operating budgets that project their revenues and expenditures well into the future. This gives them a better ability to project operating costs associated with new capital improvements coming on line in future years, and also sharpens revenue and expenditure estimating skills.

The budget should be an easily understood document that reflects the costs/benefits and implications for each alternative course of action available. The additional information would enable councillor's to make financially sound decisions with full consideration to the effect of their decisions.

## 8.4 Hypothesis

A number of hypotheses exist to try and explain the relationship between expenditure and revenue in local government. The following is some of the most important for this study:

**Tax and spend.**

The most well known advocate of this approach is Milton Friedman (1978) who argued that raising taxes would simply lead to more expenditure. According to Friedman, expenditures adjust up or down, to whatever levels can be supported by revenues. On the other hand Wagner (1976) and Buchanan and Wagner (1977) have argued that concentrating taxation on direct instead of indirect taxes would lead people to demand lower expenditures.

**Spend and Tax.**

Barro (1979) said that increased taxes and borrowing result from increased government spending. Barro does not approve the idea of Buchanan and Wagner, that deficit spending itself would create the fiscal illusion that enables politicians to irresponsibly spend public funds. In addition, Peacock and Wiseman (1979) argued that increased expenditures result from crisis, and that increased expenditure levels tend to persist even after the crisis is over.

**Revenues and Expenditures change independently of each other.**

Revenue and expenditures do not have any causal interdependence with each other. This could be the case if for instance divergent interests and agendas seriously affected the budget process.

The empirical evidence seems to support the "Tax and Spend" hypothesis in papers published by Manage and Marlow (1986), Ram (1988) and Hoover and Sheffrin (1992). Manage and Marlow (1986) using annual federal data (1929 – 82) from the US found evidence for bi-directional causality but also for unidirectional causality from revenues to expenditures. Ram (1988) using annual (1929-83) and quarterly (1947-83) US data for both federal and state-local government sectors found causality running from revenue to expenditure in federal data, but predominantly from expenditure to revenue in data from the state – local government. Hoover and Sheffrin (1992) using quarterly federal US data (1950-89) found that before the 1960's the taxes appear to cause spending, but after the late 1960's taxes and spending are causally independent.

Because central government is involved in stabilisation activities, it is also possible that this could in certain cases bias the results severely towards accepting the spend and tax hypothesis.

In local government finance the tax and spend principle is applied. Decisions are made by the politicians and program managers on which revenue levels can be supported by the community. Affordability as well as political factors determine this level. Expenditure is then cut back to the levels where it can be supported by the available revenue pool. Previously this principle worked well for local government.

The current situation where other tiers of government are shifting their responsibilities to local government makes the balancing act more difficult. Responsibilities are shifted but the balancing funding is not forth coming. This means that a local authority must either raise their rates and taxes or cut back on their services. One of the first items that get cut under such circumstances is normally maintenance funds. A practise that over the longer term returns with exponentially negative financial implications.

## 8.5 Flypaper Effect

The flypaper effect means that an increase in one unit of exogenous general grant money stimulates municipal spending more than one money unit increase in municipal own source revenue. (Hines and Thaler, 1995).

The "flypaper " effect can be illustrated as follows. An R 1,000,000 grant from central government to construct a library in a community does not mean that only that 1 million is spent in the community. The local authority must also spend money on the day to day running of such library. Costs such as maintenance, books and salaries have to be paid. Over the long term the local authority will spend far more than 1 million in the community over and above the grant money received.

This flypaper effect further emphasises the need to do multi year budgets as the additional costs attracted by the original grant must be reported to the decision makers to ensure informed and financially sound decisions.

This is especially true when grant moneys is used to fund a long-term capital project. Not only is the capital money spent but also the day-to-day running of the asset attracts further expenditure over and above the grant.

## 8.6 Affordability

Expenditure on a budget needs to be funded by revenue. When approving additional expenditure the need arises for additional revenue, which normally comes from increased tariffs.

Tariff decisions should take the following into account:

- Tariffs should be reasonable and affordable, for people who use these services.

- Based on a sliding scale, so that everybody gets the basic amount free, then pay increasingly higher tariff amounts, for the amount of water or electricity they use. These higher volume tariffs are essential to cover the free basic supply to those who only use a little, to survive.
- Policy to deal with poor households that cannot afford to pay anything.
- Fair to the municipality, to recover most (or all) of the costs of providing the service to the people, so that the tariff income can pay for staff salaries, water pipe repairs, and to repay Eskom for their bulk supply of electricity to your municipality,

The extent of cross subsidisation of rates (and service charge tariffs) is one of the more difficult factors to consider when approving the budget. Cross subsidisation is the extent to which one group or (richer) ratepayers pay an additional amount so that other groups of (poorer) ratepayers can pay a lesser amount. This also effects the level of tariffs and therefore directly the affordability issues for those who are paying the higher rates to subsidise those who are financially disadvantaged. Affordability and cross subsidisation needs to be balanced very carefully.

The principle of cross subsidisation works well where the population configuration leans heavily towards the affluent sector and where the gap between rich and poor is moderate. In South Africa the population configuration leans heavily towards the financially disadvantaged with a large gap between rich and poor. Under these circumstances the long-term effect of cross subsidisation will be negative on the financially strong and they will become part of the poor.

## 8.7 Prioritisation

The prioritisation of budget requests and the subsequent decision is one of the most difficult tasks facing council and the department managers in a local authority. Political pressures sometimes play a large role in the prioritisation process. The fact however is that only a limited amount can be financed out of the available sources of revenue. With government's policy on relief to the poor this means dwindling revenue. Budgets have to be cut back and leaner budgets mean that some program expenditures have to be cut and improved efficiency could help offset some of the cuts.

New programs can only be launched if old ones are discontinued or reduced. Tough decisions must be made – tough political decisions. Citizens will have to be encouraged to do for themselves what they have come to expect from local government. Once a service is established there is public resistance to any action that would remove it or even significantly reduce it. (Tindal and Tindal, 1990).

Sound expenditure decisions require detailed information regarding the effects of alternative projects. (Musgrave and Musgrave, 1989). Attention needs to be given to the direct and indirect benefits of a project at time of evaluation.

When revenues are not enough to cover the expenses, some services must, because of their importance or a provision of law or regulation, be given a high priority. The following are examples of other things to consider when setting budget priorities, especially if there is not enough revenue to meet all the expected needs:

- Can any of the proposed items wait one year without seriously harming the municipality and its basic services?
- Can any services be provided for less money?
- Do any of the proposed budget items help save money in the long run?
- Should certain fees be raised to support the service rather than pay for it with other revenues?
- Will other services suffer if a service does not receive a certain amount of funding?
- How does the public feel about the importance of a proposed budget item?

Once the service needs of the municipality have been established they must be ranked in order of importance (prioritised). Both the governing body and the residents should be involved in setting budget priorities.

The South African Constitution states that municipalities have the responsibility to make sure that all citizens are provided with services to satisfy their basic needs. This phrase needs to be implemented with care, as the affordability principle must also be adhered to.

The most important services in local government are:

- Water supply.
- Sewage collection and disposal.
- Refuse removal.
- Electricity and gas supply.
- Municipal health services.
- Municipal roads and storm water drainage.
- Street lighting.
- Municipal parks and recreation.

These services have a direct and immediate effect on the quality of the lives of the people. For example, if the water that is provided is of a poor quality or refuse is not collected regularly, it will contribute to the creation of unhealthy and unsafe living environments. Poor services can also make it difficult to attract business or industry to an area and will limit job opportunities for residents.

How does local government prioritise and adhere to affordability? The most important factor to consider is the level (or standard) at which the service is provided. When municipalities make decisions about the level of services they should seriously consider the long-term viability of providing a service at that level. If a municipality provides a service at a higher level the costs to provide the service increases and so does the price the municipality will have to charge its customers. Since municipalities rely heavily on income received from users, if the costs are too high and people unable to pay, the municipality will lose money and as well not be able to continue to provide the service.

A further issue surrounding the over provision of a service is that once people get used to that level of service it is extremely difficult to take it away or even substantially lower it, irrespective of the costs for the local authority. Central government in South Africa suggests the following three levels of service.

**Table 8.2 Service Levels**

| Service Type | Level 1 - Basic | Level 2 - Intermediate | Level 3 - Full |
|---|---|---|---|
| Water | Communal stand pipes | Yard taps, Yard tanks | In house water |
| Sanitation | Sewage collection/disposal | VIP latrine septic tanks | Full water borne |
| Electricity | 5 – 8 Amp or non-grid electricity | 20 Amps | 60 Amps |
| Roads | Graded | Gravel | Paved/tarred kerbs |
| Storm water Drainage | Earth lined open channel | Open channel lined | Piped systems |
| Solid waste disposal | Communal (Residents) | Communal (Contractors) | Kerbside |

One of a municipality's most important tasks is to find out the needs of its citizens and how best to provide for those needs. It is with this in mind that the local government functionaries should provide alternatives to the decision-makers.

By providing two or more levels of service for programs – each clearly identifying cost and services implications, council can make an informed decision. For example: If the current standard of refuse removal is to have two removals per week, the full cost of that level of service should be shown to council. As an alternative the line functionaries should also prepare a second refuse removal budget showing the cost effect if refuse is only removed once a week. The financial side would however not be enough to make a sound decision. The health department should also provide its inputs on public health issues/risks, should the service be downsized to one removal per week.

This does not mean that two or more levels of service must be prepared for all existing programs, but rather that such an exercise must be undertaken with programmes where a new direction is being considered. Doing this for each service provided by local government would be impractical and very time consuming.

A few additional questions that needs to be asked when prioritising budgets:

- Is there anything you are doing that you can stop doing?
- Can you pay someone else less to provide a service than it costs you to do yourself?
- Do charges for services reflect the true cost of providing that service?
- Are you recovering the full overhead costs for those programs that generate their own revenue?
- Are you spending money to regulate things that could best be deregulated?
- Can you invest capital to reduce operating costs?
- Can you reduce costs and maintain or increase productivity by establishing work standards?
- Is there or can one build a mechanical device that will reduce labour costs?
- Is your capital program designed to reduce operating and maintenance costs, or will it increase them?
- Do you own any property that you could return to the tax rolls by either selling or giving it away?
- Are you spending more to repair and maintain an ageing facility than it would cost to replace it?

A system of portfolio budgeting must be introduced. This devolves priority setting to individual portfolios by encouraging and requiring line agencies to themselves identify savings and spending options within their portfolio to meet their net savings targets. This capitalises on the superior information of line agencies by including them to identify their least cost effective program in order to fund new programs. (Campos and Pradhan, 1997).

## 8.8 Accountability

As part of a wider plan to ensure local government accountability, Central Government has issued regulations in accordance with section 12 of the Local Government Transition Act (Act No. 209 of 1993) on financial reporting by local government. These regulations were published in Government Gazette No. R 1536 of 14 November 1997.

Local government is, under these regulations, compelled to report a large number of key factors on a regular basis. Some of these requirements are.

- A comprehensive analysis of outstanding debt from rates and service charges
- Debt turnover rate
- Actions taken against payment defaulters
- Bank reconciliation's
- Investment portfolios
- Cash flow predictions, etc.

A lot of emphasis is placed on ratios in the required reporting. However for any ratio to really mean something to the analyst, previous months/year's ratios must be shown in comparison to the most recently calculated ratio. This will show the trend over a period of time and will clearly indicate improvement or degradation. This reporting is aimed at accountability to a higher level of government. Although this is surely needed, a downward accountability to the ratepayers is also needed.

Property tax is a very visible tax. To a considerable extent the property tax finances services which are also very visible such as roads and neighbourhood parks. Visibility is clearly desirable from a decision making perspective because it makes taxpayers aware of the costs of public services. This awareness enhances accountability, which is a good thing from both an economic (hard budget constraint) and political (democratic) perspective. (Bird and Slack, 2004)

An important part of accountability is to communicate information to all interested parties on an on going basis. That way the average voter will know what is planned by the local authority as well as how effectively his taxes were applied to the benefit of the community.

## 8.9 Communication

### 8.9.1 Traditional Tax Billing

Information on the Tax bill should be kept simple and should not go into too much detail. The primary purpose of the bill is to communicate billing information. Taxpayers want information on the amount of tax they had to pay, did they qualify for benefits/discounts, how can they appeal, what was the taxes spent on, how do they benefit from the spending and why had it increased this year. Local government should on a regular basis provide its taxpayers with this information by means of an information brochure. The current tax bills cannot accommodate this, as it will become too cluttered with information to ensure ease of reading and understanding. Therefore a separate brochure is necessary.

### 8.9.2 E-Billing

There is an international trend to start billing selective ratepayers by electronic means. This change is slow however. E-Billing would provide the immediate service of demand notices and provide savings for authorities in the printing and postage of conventional bills. The biggest advantage of E-Billing is that taxpayers can dig beneath the surface of their bill in as much or as little detail as they want as they can follow links to the council.

A number of authorities have raised concerns about their ability to prove service of electronic bills in any enforcement action. Service of bills in the conventional way was "proved" by production of a statement by the authority, that the bill has been mailed. Any bill sent, and not returned as undelivered, should be legally deemed to have been delivered.

Some people will reason that E-Billing will only serve a select portion of the community, as the majority of ratepayers do not have computers, or the means to effect electronic money transfers. To some extent this is true, however with a closer look at the composition of ratepayers, especially with relief measures for the poor, one will find that those who carry the majority of the tax burden is the ones who will benefit from such a program.

E-Billing would not replace other methods of service, but would simply be another option for authorities where a taxpayer indicates they would be prepared to receive their bills in this way. There would of course be no compulsion either upon taxpayers to receive their bills electronically, or upon authorities to use it in every case where a taxpayer requests it. It might, for example, be sensible to limit this application to taxpayers that pay their bills by direct debit, and perhaps those who have a good payment record.

### 8.9.3 General Communication

In an effort to achieve transparency, local government should place their financial statements and or year-end reports on the World Wide Web. This is the norm in the other three countries forming part of this study. In addition to these council resolutions, as well as the reports, which led to those resolutions should be made available electronically. This would not only be a great source of information for the public, but would also enhance accountability.

Central Government can also have the responsible department place this information on a central database accessible to the general public. This way the interested reader who wishes to make comparisons can find all local government information in one place.

Insufficient effort has been devoted to educating the public (and the media) about the unrealistic nature of their demands for tax relief and continuing high standards of service. (Tindal and Tindal, 1990). By presenting more information on a timely basis this education process can be started. Additional education programs by means of newspaper articles, brochures and posters are also needed to give perspective on the information that is now available. The more informed and educated the voter becomes in local government matters the less unrealistic demands they will make from local government.

The community should be involved as much as possible in deciding what should be the spending priorities for the area they live in. In turn they, the community can only be meaningfully involved in the process if they are properly informed about the workings of local government. One of the biggest challenges for the local authority is to get the community interested enough to participate in a meaningful manner. Experience has shown that very few people and large stakeholders attend meeting where they are informed on general local government issues. The reason for this could be apathy or that the community is generally happy with the level of services and tariffs/rates.

## 8.10 Cash Management

As an integral element of public expenditure management, governments need to develop cash planning and management to keep within budgeted expenditure in cash terms.

Cash planning has three main objectives; (1) to ensure that expenditures are smoothly financed during the year, so as to minimise borrowing costs; (2) to enable the initial budget policy targets, especially the surplus or deficit, to be met; and (3) to contribute to the smooth implementation of both fiscal and monetary policy. (IMF)

Even if a budget is realistic in the sense of having well prepared and objective aggregate revenue and expenditure estimates, this does not mean that the budget execution will be smooth. Timing problems can be expected between payments coming due and the availability of the cash necessary to discharge them. This would lead to the need for bridging finance, which in turn generates more expenditure, in the form of interest, to be paid out of the already scarce revenue resources.

A starting point should be an annual cash plan, prepared in advance of the fiscal year, setting out projected cash inflows month by month. When it appears from the initial projections that there might not be enough cash available within a given month to cover expenditures falling due, a government can delay the planned commitment of the expenditure or speed up the collection of revenue or borrow.

## 8.11 Conclusion

The level of a local authority's budget will differ from that of its neighbouring authorities due to the size, population and level of services provided. It is however the responsibility of each local authority to keep its rates and tariffs at an affordable level. This must be done with due cognisance of community needs.

Alternative ways for budget preparation must be developed to provide the decision making body with not only financial information on the current level of service, but also on alternatives and their effects on the community. All costs, short and long term should be presented together with all other relevant information. The community must also be allowed to provide input into the budget process to ensure that their needs are met.

New projects as well as the level of services have an effect on rates and tariffs. It is of the utmost importance that these be kept at an affordable level for the general public. This sometimes means that budgets/projects must be cut and hard decisions will be necessary.

These hard decisions will become easier to defend when the media and general public are educated by the local authority about local government affairs. More effort from local government side is needed in this education process to show the public the unrealistic nature of their demands. A start to this would be to make as much information as possible available to the general public.

# CHAPTER NINE
# CONCLUSIONS AND RECOMMENDATIONS

## 9.1 Introduction

The financial dilemma local government finds itself in can be partially placed at the door of central and provincial government. Various provincial governments have, over time, shown the tendency to transfer more responsibilities to the local level. This is done to ease their, provincial government's, financial difficulties. The larger responsibilities and therefore additional costs are not accompanied by corresponding funding. Provincial government, simultaneously with the transfer of responsibilities, is reducing the rate of increase in transfer payments.

This vast increase in responsibilities without the concurrent increase in the revenue base has placed a severe strain on the finances of local authorities. Local government, notwithstanding its reduced revenue, is still expected to fulfil its role of providing good governance. One should remember that the delivery of basic municipal services to all communities is dependent on the effective performance of local government. A performance which is seriously hampered by a shortage of financial resources.

Local government revenue in South Africa is mainly self-generated through property taxes and service fees generated from the delivery of services to residents and businesses. The revenue generated out of these sources is not sufficient to finance the needs of local government in full. The importance of developing new revenue sources to make local government more independent cannot be stressed enough.

One method to increase revenue is to increase property tax and service fees. Under the current political climate, where central government promotes relief measures for the poor such as the right to free basic services, this surely is not a feasible option.

The sphere of local government taxation is heavily regulated and it is sometimes difficult to find alternative solutions to broaden the tax base. Alternative methods will therefore have to be found to broaden the tax base for local government. This may require local government as a whole to request some legislation changes to enable them to bring about change.

This study dealt with best practise in general local government taxation in four countries, which follow the same local government system. In the study it was found that South Africa demonstrates a high reliance on property tax as a revenue source. Property tax is a direct tax and as such is only addressing/taxing the property owners in the community. Greater emphasis should be placed on a more indirect tax to broaden the tax base.

The development of new revenue sources is however not the only answer to the financial dilemma local government finds itself in. If the additional revenue cannot be found local government must cut back on its expenditure.

The best solution for this financial dilemma is to find a balance between additional taxation of the community as a whole, and the prioritisation of expenditure to obtain sustainable local government. By reaching this balance local government will be able to fulfil its responsibility to provide good governance.

The main reasons for reform in property tax systems world wide has been (1) to simplify the tax system, (2) to raise more revenues from property taxes, and (3) to remove inequities in the tax system. (Bird and Slack, 2004)

## 9.2 South African Scenario

Over the past decade, local government in South Africa has seen dramatic changes in legislation. The latest is the move towards one set of rules regulating local government taxation in South Africa. In an effort to ensure that all local authorities in South Africa use the same basis for property rates, the central government has started with legislation specifically dealing with the raising of property rates.

As such it establishes a uniform system of regulation and lays down parameters that are necessary to avoid material and unreasonable prejudice to national economic policies.

According to the proposed legislation, property rates will be calculated on the improved value of the property as a whole. The first fifteen thousand Rand of the valuation is however exempt from property taxation. This creates a loss in potential revenue through legislation and is out of the control of local government. The loss of revenue, due to exemptions, will have to be made good from either increased property rates or the finding of new and innovative revenue sources to tap into.

## 9.3 International Scenario

Both Australia and Canada follow the principle that property taxation is based on market value. Market value implies the improved value of the property. In England the municipal tax system is not purely based on the market value of the property, but rather on the occupants of the property. England is also the only country under review that relies heavily on governmental grants to finance its operations.

Of specific interest were the linear tax principle applied in Alberta Canada and the average valuation system used in Queensland Australia.

The linear tax principle comprises an indirect tax method as infrastructure used by commercial companies to distribute services is taxed. This ensures that all users of that service carry part of the taxation burden.

The Queensland average valuation system on the other hand provides a stable revenue flow. This is possible due to the average valuation over three years being used to ease extreme property market fluctuations. Ontario, Canada is planning to implement a similar average tax system in the year 2005

## 9.4 Application of International Trends

The recommendations pertained in this section was sent to a number of local authorities in South Africa for their comments. The returned comments were incorporated into the study as a whole and where necessary, recommendations were amended to ensure practicality of the recommendations.

### 9.4.1 Valuations

Property tax is based on the valuation or market value of a given property. One of the problems facing the local authority is to estimate the market value of each and every property within its area of jurisdiction in a fair and consistent manner. Due to the sheer volume of properties and the uniqueness of each it is not possible to physically visit and value each property.

The sales comparison approach is widely accepted as the best practise to overcome the volume problem. Under this approach property characteristics are compared to homes that have sold in order to determine which characteristics are important and to what extent they are important in explaining the sales price. A number of factors such as supply and demand, community and surroundings and physical attributes have an influence on the market value of the property. Assessments are then estimated for all the properties based on those that have sold.

One should at this point also remember that the market value of a property is taken as the improved value of the property. Market value thus includes land, buildings and any legal rights on that property.

For property taxes to stay current with economic growth in the area, valuations must take place on a yearly basis. This is consistent with the international trend. However, basing taxes on a one-year only valuation may leave the local authority and or ratepayer open to unreasonable fluctuations in amounts due. These fluctuations are due to the volatility of the property market in a given set of economic circumstances.

Local authorities should try and equalise these fluctuations by implementing a three-year average valuation system. Properties under this system are still valued on a yearly basis but for calculation of the property tax, the average of at least three valuations is used. This system is successfully followed in Queensland, Australia. Consideration must however also be given to the scenario where commercial property values can substantially drop, and leave the owners with values they cannot afford to pay tax on.

It is however important to take into account the cost factor of yearly valuations. A valuation frequency needs to be found where the valuation cost is at an acceptable ratio to the tax revenue gained. The validity of market values as indicator of the current economic climate also needs to be factored into the equation.

### 9.4.2 Exemptions

Central and provincial government normally prescribes what exemptions the local authority may give. This is also the case in South Africa where central government is going one step further by putting compulsory exemptions in place to provide relief for the poor. One such example is the exemption of the first R15,000 of any property value from taxation.

Care must be taken not to have too many exemptions in place, whether discretionary or not, as it erodes the tax base. Exemptions have the effect that the general tax rate has to be increased to make good the revenue lost. These exemptions should also be discretionary as local conditions and the ability to pay differs from city to city. The local authority best knows unique local circumstances and the current economic climate.

## 9.4.3 Minimum Tax

Minimum tax amounts ensure that a local authority recovers at least the basic amount to fund basic services to that community. It shows its value in circumstances where property valuations are unnaturally low. These low values may be due to market and other socio-economic forces and does not reflect the real replacement value of the property.

It is only fair that the lower value properties contribute at least the basic level of property tax needed by the local authority. All other properties must then make good the difference between the basic level and the actual cost of services to that community.

## 9.4.4 Indirect Tax

Indirect taxes are taxes which are imposed at some other point in the system, but are meant to be shifted to whomever is supposed to be the final bearer of the burden. Linear tax fits in with this definition and is therefore a form of indirect tax. The tax is imposed on the company who uses the infrastructure to provide goods and services for profit. This company passes the tax on to the user of the service or goods irrespective of property ownership.

Linear tax is such a system as infrastructure or the use thereof is taxed in the hands of the service provider. The principle stems from the infrastructure needed or used to provide selected services. The infrastructure runs on or under municipal land and the companies are using this land and infrastructure to generate profitable business. The use of council controlled or owned property (assets) by utility companies should attract cost just as the use of any other commercial asset would. Therefore the use of the asset is taxed in the hands of the service provider. The tax is later passed on to the end user.

Linear tax provides a good and explainable base from which calculations can be done to determine cross subsidisation of property tax from services. It also provides an efficient indirect tax vehicle to ensure that the broader public (non-property holders) contributes towards tax revenue.

### 9.4.5 Legislation Changes

Changes will be needed on the current local government legislation to give local authorities more discretionary powers. The current legislation is very restrictive and does not leave room for council's discretion. The exemption of the first R15,000 of property value from property tax is a good example of this. Each local authority should be allowed to determine its own minimum exempt amount or at the very least a sliding scale should be determined.

This needs to be done to create a fair and equitable relief system for the poor and the local authority alike. The current level will have a major detrimental effect on small local authorities whereas large local authorities will more readily be able to absorb the effect of the exemption.

Changes should encompass setting a percentage of property value as exempt amount rather than a fixed monetary amount. A maximum property value on which this percentage is to be applied should also be set as the purpose of such an exemption is to provide relief to the poor. Such a system will be fair to both large and small local authorities.

A number of smaller changes are also needed in the legislation to ensure the maximisation of the available tax resources. One of these would be the incorporation of legislation to deal with indirect tax. This would shift some of the tax burden away from property owners and place it in the hand of end users of a service.

As with the other recommendations the proposed legislation changes was sent out for comments to local authorities in South Africa. The comments received were analysed and where necessary amendments done to the proposed recommendations to reflect the practical implementation thereof.

## 9.5 Budget Prioritisation

A number of factors influence the expenditure of a particular local authority. The combination of residential and industrial properties, age of population as well as property ownership of population is but three of the factors that make a local authority unique in its spending pattern. It is important that a budget reflects the needs, goals and objectives of the community.

During budget preparation a local authority has to give attention to prioritisation of expenses as well as communicating its decisions to the public. It cannot just increase rates and service charges to meet the needs of the community. Affordability of the services must be taken into consideration before deciding on a specific service or level of service.

Alternative ways for budget preparation must be developed and implemented. The information provided to the decision making body must encompass more than just financial information as in current practice. The information should also include alternative levels of service, their costs and effects on the community. By providing two or more levels of service for programs, each clearly identifying costs and service implications, council can make an informed decision. All costs, short and long term, together with all other relevant information should be provided to the decision-makers. It is only with this complete information at hand that they will be put into a situation where tough decisions can be made. Due to practical implications such alternatives should only be prepared for services where a new direction is under consideration.

Some of the alternative approaches to consider in the budget process are:

- Good practice in estimating revenue will be to assume that no more funds will be available next year than this year from any source.
- Keep in mind that money received from a source this year may not be available next year.
- The budget process should start with council providing some goals and objectives to the program managers.
- Take a multi year approach in budgeting as it will clearly show future costs of a project started in the current year.
- Additional flexibility can be provided by allowing programs to carry forward running costs between years up to a limit of 10%.

## 9.6 Communication

Local government receives a lot of criticism from the media and the public at the time the budget is released and new rates and service fees implemented. Nobody wants to pay more but expects the best possible service from their local authority. Some may also feel that they wanted a certain project to go ahead and cannot understand why the local authority cannot implement that project.

The main reason for this criticism is the lack of communication between the local authority and all stakeholders in the community. Local government has made insufficient effort to educating and informing the public and media about the unrealistic nature of their demands. They, the public, must be shown why these demands could not be met and if they were met what the cost would be to the community in increased rates and service charges. Even if a project was originally funded by a grant there will still be ongoing operating costs that must be funded through user fees and taxes.

A challenge that also faces local government in this regard is to get the community interested enough in local government affairs to participate. The origin of the current lack of participation is difficult to determine. It could be caused by apathy or simply because the community is generally happy with the level of service and tariffs/rates.

The hard decisions needed to balance the budget and keep rates and service fees affordable will become easier to defend when the media and general public are educated into local government affairs. This education process is the responsibility of local government and more attention should be given into this area.

The information highway of the World Wide Web should also be used more effectively to provide information to the general public and interested parties. Financial statements, year-end reports and other information should be posted on the web. This will enhance transparency from the local authority to its people.

## 9.7 Conclusion

The purpose of this study is to build a model for local government in South Africa, which will not only broaden the tax base but will also address budget control and accountability issues.

The research showed that although basic principles of property tax as applied by local governments in the target countries is the same; there are unique best practises that can be applied to South Africa. These best practices were investigated and analysed and then applied to the South African scenario. The application of the best practises were done by means of a financial model to show the monetary effect each of these will have on the potential property tax revenue and therefore also the broadening of the tax base. The model shows that, by implementing the recommendations made, the negative effect of legislative exemptions can, to a large extent, be countered.

The tax base can be broadened by the implementation of indirect tax in the form of a well-regulated linear tax. This is achieved by taxing not only the property owner but by allowing him to pass down this tax to the end user, which includes non-property owners.

Legislation changes in South Africa will however be necessary to accommodate these best practices. Should local government wish to implement these recommendations it will be the task of organised local government to lobby with central government to have legislation amended.

The study also showed best practices in budget control and budget processes. Local government will have to undergo a mindset change to implement the recommendations made. Multi year budgets are proposed as well as alternative budgets that will enable councillors to not only make hard financial decisions but also to defend those decisions to their voters. It is important for local government from an accountability perspective to undergo this change.

Accountability not only entails careful budgeting but also open communication to the voters within that area. Surely voters and the media will be more understanding if they are properly informed and schooled on the workings of their local government. This will not only make local government accountable to its ratepayers but will also foster a sense of accountability with the ratepayers to each other and the local authority.

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*Appendix 1*

# TERMINOLOGY

**Bylaw** - A regulation made by a local authority or corporation (Concise Oxford Dictionary, 1992:154).

**Council** - The elected local administrative body of a parish, district, town, city or administrative county and its paid officers and workforce (Concise Oxford Dictionary, 1992:262).

**Franchise Fees** - means a fee in lieu of taxes based on an agreement with the holder of a special franchise, e.g., cable TV use of City right-of-way.

**Improved Value** - means the value of property including improvements.

**Improvements** - means land and any building attached to land, whether removable or not, or any other immovable structure in, on or under the land or pertaining to a right in property, excluding:

a) a structure constructed solely for the purpose of rendering the land concerned suitable for the erection of any immovable structure thereon; and
b) any underground building attached to land, whether removable or not, or any other immovable underground structure on land which is the subject matter of any mining authorisation or mining right. (Local Government: Municipal Rating Bill, 2000).

**Linear Taxes** – Linear tax is a form of indirect tax raised on property such as electric power systems, street lighting, telecommunication systems and pipelines used for the gathering, distribution or transportation of a commodity. This property specifically excludes land and buildings, which are taxed under normal tax regulations.

**Local Government** - A system of administration of county, district, parish, etc. by selected representatives who live there (Concise Oxford Dictionary, 1992:695).

**Market Value** - It is necessary to properly define market value when it is used for property tax purposes. In short, market value means the amount that a property might be expected to realise if a willing seller sells it on the open market to a willing buyer. Generally Accepted Municipal Accounting Practice (GAMAP 102) defines "Open Market Value" as the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's length transaction. Professional valuers accept that the purpose of the valuation will determine the method followed. Therefore the method followed for valuations done to determine property tax will differ from the norm. Outside local government "Fair Value" or market value is defined as the most advantageous price realistically obtainable by a seller from a buyer who is reasonably informed about the nature and characteristics of the asset (IAS 16).

Three methods may be used to determine market value in local government:

- A comparison and analysis of similar properties that have sold.
- Analysis of the rental income properties generates.
- The replacement cost on a building plus a value for vacant land.

Such market value in turn may be influenced by

- The supply and demand for property of particular types or locations.
- The community or where the home is located in the community plus the surroundings. For example, a location beside a large park may add value whereas a location on a traffic corridor may reduce the market value.
- Physical attributes such as size, age and condition, existence and type of garage all affect market value.

**Municipality** - A town or district having local government (Concise Oxford Dictionary, 1992:778).

**Overspending** - in relation to the budget of a municipality, means when the operational or capital expenditure incurred by the municipality during a financial year, exceeds the total amount appropriated in that years budget for its operational or capital expenditure as the case may be (Municipal Finance Management Bill, 2000).

**Owner** - means the person in whose name the property or the right to property is registered but also including:

a) The trustee, in the case of trust property.
b) The executor or administrator, in the case of a deceased estate.
c) The trustee or liquidator, in the case of property in an insolvent estate or in liquidation.
d) The judicial manager, in the case of property under judicial management.
e) The curator in the case of property under curatorship.
f) The usufructuary, in the case of property that is subject to usufruct.
g) the lessee, in the case of a property that is subject to -
    i) A registered lease.
    ii) A lease for a period of not less than ten years or for the natural life of either the lessee or another person mentioned in the lease; or
    iii) A lease that is renewable from time to time by the lessee indefinitely or for periods which together with the first period amount to not less than ten years, whether or not that renewal is dependant on the periodic consent or permission of, or the periodic renewal of a licence by, an organ of state; or
i) The lessee, in the case of property that is registered in the name of the municipality and is leased by it. (Municipal Government: Municipal Rating Bill, 2000).

**Public Infrastructure** - means

a) National, provincial or other public roads on which goods, services or labour move across a municipal boundary;
b) Water or sewer pipes, ducts or other conduits, and dams and water supply reservoirs, forming part of a water or sewer scheme serving the public across a municipal boundary;
c) Power stations, substations or power lines forming part of an electricity scheme serving the public across a municipal boundary;
d) Pipelines for gas and liquid fuels, forming part of a scheme for transporting such fuels across a municipal boundary;
e) Railway lines forming part of a national railway system;
f) Telecommunication towers or lines forming part of a telecommunications system serving the public across a municipal boundary
g) Runways or aprons at national or provincial airports;
h) Waterways at harbours to and from which goods, services or labour move across a municipal boundary; or
i) Rights of way, easements and servitude's in connection which infrastructure mentioned in paragraphs (a) to (h).

# ASSUMPTIONS

*Appendix 2*

| | | | | |
|---|---|---|---|---|
| Property Tax Rate | 0.087 | | | |
| Linear Tax Rate | 0.080 | | | |
| | | | | |
| Single Residential Units | 10,000 | Units | | |
| Valuation Bands | | | | |
| A 1 - 25,000 | 2,000 | Units | 25,000.00 | Value per unit |
| B 25,001 - 50,000 | 1,000 | Units | 50,000.00 | Value per unit |
| C 50,001 - 100,000 | 4,000 | Units | 100,000.00 | Value per unit |
| D 100,001 - 150,000 | 2,000 | Units | 150,000.00 | Value per unit |
| E 150,001 - 200,000 | 1,000 | Units | 200,000.00 | Value per unit |
| | | | | |
| Multiple Residential Blocks | 27 | Blocks | | |
| Units per block | 20 | Units | | |
| Value of each unit | 50,000.00 | | 1,000,000.00 | Per Block |
| | | | | |
| Government Properties | 10 | Units | | |
| Value per unit | 2,000,000.00 | | | |
| | | | | |
| Government mandate on exemptions | - 15,000.00 | | | |
| | | | | |
| Electricity Network | | | | |
| Sales | 200,000,000.00 | | | |
| Km length of network | 400 | Km | | |
| Base Value per Km | 600,000.00 | | | |
| Number of Street light poles | 5,000 | | | |
| Base Value per Pole | 2,500.00 | | | |
| | | | | |
| Water Network | | | | |
| Sales | 55,000,000.00 | | | |
| Km Length of network | 300 | | | |
| Base Value per Km | 250,000.00 | | | |

**_Appendix 2_** **(Continued)**

| | |
|---|---|
| Telephone Network | |
| Number of connections | 10,540 |
| Base Value per connection | 500.00 |
| Government Grants | 15,200,000.00 |
| Minimum tax to cover basic services | 1,500.00 |
| Cross Subsidisation | 10% |

*Source: Own research*

## FINANCIAL MODEL WITH:

*Appendix 3*

**BASE MODEL ONLY**

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0870 | 4,350,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0870 | 4,350,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0870 | 34,800,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0870 | 26,100,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0870 | 17,400,000.00 | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0870 | 2,349,000.00 | |
| Government units | 10 | 2,000,000.00 | 20,000,000.00 | - | - | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 109,349,000.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **379,549,000.00** |

***Appendix 3*** **(Continued)**

| | | |
|---|---|---|
| Annual Property Tax per Residential Unit | Band A | 2,175.00 |
| | Band B | 4,350.00 |
| | Band C | 8,700.00 |
| | Band D | 13,050.00 |
| | Band E | 17,400.00 |

*Source: Own research*

# FINANCIAL MODEL WITH:

*Appendix 4*

**BASE MODEL**

***LESS EXEMPTION***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0870 | 4,350,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0870 | 4,350,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0870 | 34,800,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0870 | 26,100,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0870 | 17,400,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0870 | - 2,610,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0870 | - 1,305,000.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.0870 | - 5,220,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0870 | - 2,610,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0870 | - 1,305,000.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0870 | 2,349,000.00 | |
| Government units | 10 | 2,000,000.00 | 20,000,000.00 | - | - | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 96,299,000.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **366,499,000.00** |

| | | |
|---|---|---|
| Exemption is prescribed by central government thus mandatory | | |
| Annual Property Tax per Residential Unit | Band A | 870.00 |
| | Band B | 3,045.00 |
| | Band C | 7,395.00 |
| | Band D | 11,745.00 |
| | Band E | 16,095.00 |

*Source: Own research*

# FINANCIAL MODEL WITH:

***Appendix 5***

**BASE MODEL**

**LESS EXEMPTIONS**

***PLUS RATES INCREASE***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.1019 | 5,095,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.1019 | 5,095,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.1019 | 40,760,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.1019 | 30,570,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.1019 | 20,380,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.1019 | - 3,057,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.1019 | - 1,528,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.1019 | - 6,114,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.1019 | - 3,057,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.1019 | - 1,528,500.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.1019 | 2,751,300.00 | |
| Government units | 10 | 2,000,000.00 | 20,000,000.00 | - | - | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 109,366,300.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **379,566,300.00** |

**_Appendix 5_** **(Continued)**

| | | |
|---|---|---|
| Rates increase is needed to recover lost revenue due to mandatory revenue | | |
| Annual Property Tax per Residential Unit | Band A | 1,019.00 |
| | Band B | 3,566.50 |
| | Band C | 8,661.50 |
| | Band D | 13,756.50 |
| | Band E | 18,851.50 |

*Source: Own research*

# FINANCIAL MODEL WITH:

***Appendix 6***

**BASE MODEL**
**LESS EXEMPTIONS**
**PLUS RATES INCREASE**
***PLUS GOVERNMENT GRANT FOR PROPERTY RATES***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.1019 | 5,095,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.1019 | 5,095,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.1019 | 40,760,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.1019 | 30,570,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.1019 | 20,380,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.1019 | - 3,057,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.1019 | - 1,528,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.1019 | - 6,114,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.1019 | - 3,057,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.1019 | - 1,528,500.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.1019 | 2,751,300.00 | |
| Government units/Grant | 10 | 2,000,000.00 | 20,000,000.00 | 0.1019 | 2,038,000.00 | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 111,404,300.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **381,604,300.00** |

| | | |
|---|---|---|
| This grant on property tax will help offset the increase made due to the mandatory increases | | |
| Annual Property Tax per Residential Unit | Band A | 1,019.00 |
| | Band B | 3,566.50 |
| | Band C | 8,661.50 |
| | Band D | 13,756.50 |
| | Band E | 18,851.50 |

*Source: Own research*

## FINANCIAL MODEL WITH:

***Appendix 7***

**BASE MODEL**

**LESS EXEMPTIONS**

**PLUS RATES INCREASE**

**PLUS GOVERNMENT GRANT FOR PROPERTY RATES**

***LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0997 | 4,985,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0997 | 4,985,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0997 | 39,880,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0997 | 29,910,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0997 | 19,940,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0997 | - 2,991,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0997 | - 1,495,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.0997 | - 5,982,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0997 | - 2,991,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0997 | - 1,495,500.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0997 | 2,691,900.00 | |
| Government units/Grant | 10 | 2,000,000.00 | 20,000,000.00 | 0.0997 | 1,994,000.00 | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 109,430,900.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **379,630,900.00** |

| | | |
|---|---|---|
| Lowering of rates to give advantage received from government grant back to rate payers | | |
| Annual Property Tax per Residential Unit | Band A | 997.00 |
| | Band B | 3,489.50 |
| | Band C | 8,474.50 |
| | Band D | 13,459.50 |
| | Band E | 18,444.50 |

*Source: Own research*

# FINANCIAL MODEL WITH:

***Appendix 8***

**BASE MODEL**

***IMPLEMENTING MINIMUM TAX***

**LESS EXEMPTIONS**
**PLUS RATES INCREASE**
**PLUS GOVERNMENT GRANT FOR PROPERTY RATES**
**LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE**

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0997 | 4,985,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0997 | 4,985,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0997 | 39,880,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0997 | 29,910,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0997 | 19,940,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0997 | - 2,991,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0997 | - 1,495,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.0997 | - 5,982,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0997 | - 2,991,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0997 | - 1,495,500.00 | |
| Minimum Tax | | | | | | |
| Residential Units Band A | 2,000 | | | 1,500.00 | 3,000,000.00 | |
| Residential Units Band B | - | | | 1,500.00 | - | |
| Less Band A Net Tax | | | | | - 1,994,000.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0997 | 2,691,900.00 | |
| Government units/Grant | 10 | 2,000,000.00 | 20,000,000.00 | 0.0997 | 1,994,000.00 | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 110,436,900.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **380,636,900.00** |

| | | |
|---|---|---|
| Implementing minimum tax where normal property tax less exemptions is lower than the R 1,500 minimum | | |
| Annual Property Tax per Residential Unit | Band A | 1,500.00 |
| | Band B | 3,489.50 |
| | Band C | 8,474.50 |
| | Band D | 13,459.50 |
| | Band E | 18,444.50 |

*Source: Own research*

# FINANCIAL MODEL WITH:

***Appendix 9***

**BASE MODEL**
**LESS EXEMPTIONS**
**PLUS RATES INCREASE**
**PLUS GOVERNMENT GRANT FOR PROPERTY RATES**
**LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE**

**IMPLEMENTING MINIMUM TAX**
***2nd LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0985 | 4,925,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0985 | 4,925,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0985 | 39,400,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0985 | 29,550,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0985 | 19,700,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0985 | - 2,955,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0985 | - 1,477,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.0985 | - 5,910,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0985 | - 2,955,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0985 | - 1,477,500.00 | |
| Minimum Tax | | | | | | |
| Residential Units Band A | 2,000 | | | 1,500.00 | 3,000,000.00 | |
| Residential Units Band B | - | | | 1,500.00 | - | |
| Less Band A Net Tax | | | | | - 1,970,000.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0985 | 2,659,500.00 | |
| Government units/Grant | 10 | 2,000,000.00 | 20,000,000.00 | 0.0985 | 1,970,000.00 | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | 0.1000 | 20,000,000.00 | 109,384,500.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **379,584,500.00** |

Implementing minimum tax where normal property tax less exemptions is lower than the R 1,500 minimum

| | | |
|---|---|---|
| Annual Property Tax per Residential Unit | Band A | 1,500.00 |
| | Band B | 3,447.50 |
| | Band C | 8,372.50 |
| | Band D | 13,297.50 |
| | Band E | 18,222.50 |

*Source: Own research*

# FINANCIAL MODEL WITH:

***Appendix 10***

**BASE MODEL**
**LESS EXEMPTIONS**
**PLUS RATES INCREASE**
**PLUS GOVERNMENT GRANT FOR PROPERTY RATES**
**LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE**
**IMPLEMENTING MINIMUM TAX**
**2nd LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE**
***PLUS LINEAR TAX AND LESS CROSS SUBSIDIES***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0985 | 4,925,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0985 | 4,925,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0985 | 39,400,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0985 | 29,550,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0985 | 19,700,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0985 | - 2,955,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0985 | - 1,477,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.0985 | - 5,910,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0985 | - 2,955,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0985 | - 1,477,500.00 | |
| Minimum Tax | | | | | | |
| Residential Units Band A | 2,000 | | | 1,500.00 | 3,000,000.00 | |
| Residential Units Band B | - | | | 1,500.00 | - | |
| Less Band A Net Tax | | | | | - 1,970,000.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0985 | 2,659,500.00 | |
| Government units/Grant | 10 | 2,000,000.00 | 20,000,000.00 | 0.0985 | 1,970,000.00 | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | - | - | |
| Linear Tax | | | | | | |
| Street Lights | 5,000 | 2,500.00 | 12,500,000.00 | 0.080 | 1,000,000.00 | |
| Electricity Network | 400 | 600,000.00 | 240,000,000.00 | 0.080 | 19,200,000.00 | |
| Water Network | 300 | 250,000.00 | 75,000,000.00 | 0.080 | 6,000,000.00 | |
| Telephone Network | 10,540 | 500.00 | 5,270,000.00 | 0.080 | 421,600.00 | |
| | | | | | | 116,006,100.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **386,206,100.00** |

**_Appendix 10_** **(Continue)**

| | | |
|---|---|---|
| Implementing Linear Taxation | | |
| Annual Property Tax per Residential Unit | Band A | 1,500.00 |
| | Band B | 3,447.50 |
| | Band C | 8,372.50 |
| | Band D | 13,297.50 |
| | Band E | 18,222.50 |

*Source: Own research*

# FINANCIAL MODEL WITH:

***Appendix 11***

**BASE MODEL**
**LESS EXEMPTIONS**
**PLUS RATES INCREASE**
**PLUS GOVERNMENT GRANT FOR PROPERTY RATES**
**LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE**
**IMPLEMENTING MINIMUM TAX**
**2nd LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE**
**PLUS LINEAR TAX AND LESS CROSS SUBSIDIES**
***3rd LOWERING OF RATE TO EQUALISE ADDITIONAL REVENUE***

| Description | Number | Value Per Unit | Total Value | Rate | Property Rates Revenue | Total Municipal Revenue |
|---|---|---|---|---|---|---|
| Property tax | | | | | | |
| Residential Units Band A | 2,000 | 25,000.00 | 50,000,000.00 | 0.0911 | 4,555,000.00 | |
| Residential Units Band B | 1,000 | 50,000.00 | 50,000,000.00 | 0.0911 | 4,555,000.00 | |
| Residential Units Band C | 4,000 | 100,000.00 | 400,000,000.00 | 0.0911 | 36,440,000.00 | |
| Residential Units Band D | 2,000 | 150,000.00 | 300,000,000.00 | 0.0911 | 27,330,000.00 | |
| Residential Units Band E | 1,000 | 200,000.00 | 200,000,000.00 | 0.0911 | 18,220,000.00 | |
| Exemptions | | | | | | |
| Residential Units Band A | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0911 | - 2,733,000.00 | |
| Residential Units Band B | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0911 | - 1,366,500.00 | |
| Residential Units Band C | 4,000 | - 15,000.00 | - 60,000,000.00 | 0.0911 | - 5,466,000.00 | |
| Residential Units Band D | 2,000 | - 15,000.00 | - 30,000,000.00 | 0.0911 | - 2,733,000.00 | |
| Residential Units Band E | 1,000 | - 15,000.00 | - 15,000,000.00 | 0.0911 | - 1,366,500.00 | |
| Minimum Tax | | | | | | |
| Residential Units Band A | 2,000 | | | 1,500.00 | 3,000,000.00 | |
| Residential Units Band B | - | | | 1,500.00 | - | |
| Less Band A Net Tax | | | | | - 1,822,000.00 | |
| Property tax | | | | | | |
| Multiple units | 27 | 1,000,000.00 | 27,000,000.00 | 0.0911 | 2,459,700.00 | |
| Government units/Grant | 10 | 2,000,000.00 | 20,000,000.00 | 0.0911 | 1,822,000.00 | |
| Cross Subsidy from Electrical | | | 200,000,000.00 | - | - | |
| Linear Tax | | | | | | |
| Street Lights | 5,000 | 2,500.00 | 12,500,000.00 | 0.080 | 1,000,000.00 | |
| Electricity Network | 400 | 600,000.00 | 240,000,000.00 | 0.080 | 19,200,000.00 | |
| Water Network | 300 | 250,000.00 | 75,000,000.00 | 0.080 | 6,000,000.00 | |
| Telephone Network | 10,540 | 500.00 | 5,270,000.00 | 0.080 | 421,600.00 | |
| | | | | | | 109,516,300.00 |
| Government Grants | | | | | | 15,200,000.00 |
| Electricity Sales | | | | | | 200,000,000.00 |
| Water Sales | | | | | | 55,000,000.00 |
| | | | | | | **379,716,300.00** |

***Appendix 11*** **(Continued)**

| | | |
|---|---|---|
| Implementing Linear Taxation | | |
| Annual Property Tax per Residential Unit | Band A | 1,500.00 |
| | Band B | 3,188.50 |
| | Band C | 7,743.50 |
| | Band D | 12,298.50 |
| | Band E | 16,853.50 |

*Source: Own research*