Working paper

An effective property tax regime for Rwanda

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Contents

Executive Summary

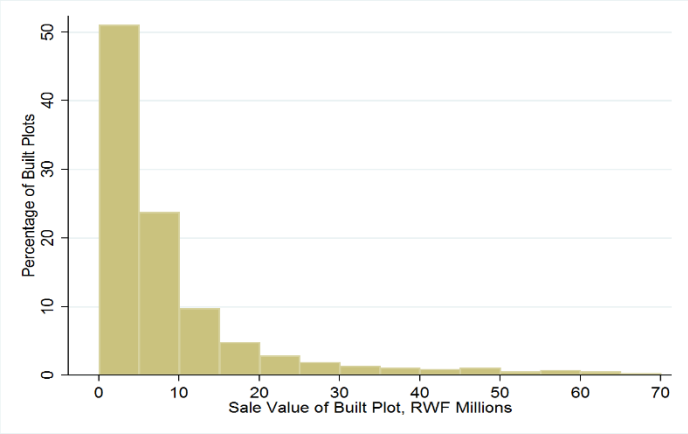
The Government of Rwanda has initiated a decentralised tax reform, with strong political will to address earlier weaknesses including a narrow tax base, low tax rate, regressive schedule, and weak tax administration.

This independent assessment commissioned by the IGC concludes that an optimal reform would include:

- A low buildings tax exemption threshold (RWF 5-10 million);
- A buildings tax rate of at least 0.5% above the threshold;
- An area-based land tax approximating 0.5-1% of land values, with bracket ranges proportionate to the real range in land values (e.g. RWF0-900/m2, stated in real terms);
- Accurate reference prices for audits and mass property valuation, ensured by removing taxes on reported sale prices;
- Consultations with key stakeholders on the final proposal.

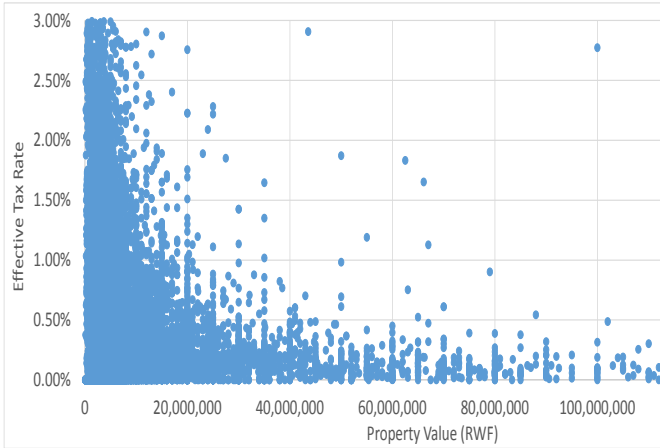
Currently, most property-owners pay a land lease fee (LLF) and about 2% pay fixed asset (property) tax (FAT). Land fees are regressive, with low-income property-owners often liable to pay 1-3% of fixed asset values, and owners of more valuable properties typically paying less than 0.15%. The land lease fees and fixed asset taxes generated little revenue: about RWF 4.3bn and 0.5bn respectively in 2015/16, comprising less than 1% of total tax revenues and 0.1% of GDP. These figures are low by international comparison: property and land taxes in Europe, the USA, many successful urbanisers in East Asia and Sub-Saharan Africa are typically 0.5-1% of market value, and generate about 5% or more of total tax revenues and 2% of GDP. The East Asian developmental states made property and land taxes a particularly important part of their development strategies; not only did they generate sustainable revenue for urban investment, they also allowed the government to reduce other taxes in other sectors, improving incentives for investment in productive industry rather than land speculation.

Figure 1. Graph to Show The Percentage of Properties in Kigali with Various Values (2015/16 LAIS Data)



This graph shows LAIS data on the reported prices of properties sold in 2015-16 in Kigali. It only includes residential plots. Because buildings are typically worth no more than two thirds of total fixed asset value (land accounts for 30-60%), this implies building values of below RWF 6.6 million for 70%, and below RWF 13.2 million for 90%.

Figure 2. The Land Lease Fee was Strongly Regressive (Kigali 2015/16 data)



This graph shows people's land lease fee liabilities as a proportion of their property values. The sample is all properties/plots that were formally transacted in Kigali in 2015/16, totalling 13,000 plots.

The draft law expands the tax base by making leaseholders liable for buildings taxes. However, it also *introduces* an exemption: any building value below an 'affordable house' threshold, initially planned to be RWF 30 million, is not taxed. **94% of property-owners in Kigali may be exempt** from the buildings tax if this exemption threshold is set at RWF 30 million**.** The best available data (e.g., *Figure 1*) suggest that 70% of properties in Kigali are worth less than RWF 10 million, and 90% are worth less than RWF 20 million. These data may include inaccuracies, but i) agree with EICV4 property price data (**Figure 9** below), and ii) are the main values to be drawn on for any mass valuation of properties for tax purposes. There are many ways to define 'affordable housing', but the threshold seems to miss the ground reality if it suggests that only 5-6% of the population live in affordable housing.

The threshold also reduces *the tax due from those who do pay* buildings tax. For example, a middle-class owner of a RWF 50 million fixed asset would pay approximately 0.02% of fixed asset value in buildings tax (a fifth of the tax rate under the previous FAT).

Table 1. Building Tax Under a 0.2% Rate and RWF 30 Million Exemption Threshold. Three Examples.

Property Value *(Land + Building)*	**Taxable Value** *(Subtract one third for Land Value and RWF 30 million exempt building value)*	**Building Tax Due** *(0.2%*Taxable Value)*	**Effective Fixed Asset Tax Rate** (*Building Tax / Total Fixed Asset Value)*
RWF 50 million	RWF 5 million	RWF 10,000	**0.02%**
RWF 80 million	RWF 23 million	RWF 46,000	**0.06%**
RWF 120 million	RWF 50 million	RWF 100,000	**0.08%**

The buildings tax rate must take into account *other taxes* on fixed assets and fixed asset income- the land tax, sales tax, and rental income tax. If any of these are too high, it would suggest taking a lower buildings tax rate, and vice versa if they are too low.

The **rental income tax** is in line with rates in other countries and a good, progressive regime,[1] so is not discussed in this paper. We also do not discuss VAT on rental income, as this is applied only where annual rent exceeds RWF 20 million on a commercial property.

The land tax in the draft law takes a similar form to the previous land lease fee, which often applied high rates to low-income land-owners, and very low rates to the most valuable plots (***Figure 2***). The new land tax could equalise the burden somewhat, using the Ministerial Instruction to assign m^2 taxes to plots more scientifically. However, the proposed upper cap on the new land tax is low, especially as prices are not inflation-adjusted: RWF120/m2 is just 0.2% of top land values, while RWF80/m2 is approximately RWF62/m2 in 2011 prices, representing a decrease in real terms. By contrast, the 'minimum' m^2 fee in the old law represented 1-3% of values for some of the least valuable plots, and has now been *raised*, from RWF10 to RWF30/m2. Thus, the land taxes would remain regressive, affecting people's overall fixed asset tax considerably, as land is often worth 30-60% of total fixed asset value.

We recommend replacing the land tax with a value-based tax. This will improve equity and affordability substantially, while introducing greater tax buoyancy (revenues rise with income and prices). However, it introduces an administrative burden to assess and audit land prices, and to correctly register plots as residential, agricultural, or commercial. If the area-based system is retained, we recommend **extending the land tax brackets at the upper and lower limits**; treating the brackets as 'base rates' which may be **multiplied to higher (or lower) levels** (outside the brackets) by the later Ministerial Instructions; and **stating tax brackets in real (or real 2011) prices** to account for rising land values.

[1] 10% is a typical rate, e.g. in Tanzania and Kenya. Rwanda's rental income tax has a progressive schedule, but for most is below 10% and is always less than 15% of total rental income.

A serious flaw in the draft local taxes law and also the Taxes on Income law (sales tax proposal) is the provision to **tax people based on the sale values they *report* to the government at the point of transaction**. An property tax regime that is sound in theory is only effective in practice if applied to reasonably **accurate property values**. Government agencies have no capacity to audit sale price declarations, so parties are incentivised to seriously under-report prices, to evade the taxes. The resultant low sale values will be fed into the land registry and will constitute the main reference prices for any mass appraisal of land and property values, as well as other audits of value declarations, and analyses to inform the Ministerial Instruction on applying land taxes to plots. In Kenya, by 2015, valuation rolls were so out-of-touch with reality that they often listed properties as 20-30 times less valuable than their true prices; in some jurisdictions, *nominal property tax rates of above 30%* were necessary just to ensure properties were taxed at a 'real' rate of around 1%. In Rwanda, all effort should be made to **assure taxpayers that their own transaction price declaration will *not* affect their tax liability**, to discourage informal transactions and encourage accurate reporting for a robust valuation roll. For the buildings tax, self-declared values can be used instead of sale values. The Sales Tax is not part of the Decentralised Taxes reform, but it would have strong and negative consequences on the property tax system through induced under-reporting. Taxing *net value appreciation* would remove incentives to under-report. The sales tax could alternatively be removed entirely and the same revenues raised through the fixed asset tax, since both tax the same asset. Either option would also reduce the 'double taxing' of fixed assets, making an 'international' building tax rate more appropriate and acceptable.

Finally, several consultations have been held to communicate and build support for the regime proposed in the draft law. If changes are made to this draft, it would be wise to hold consultations with the same parties to communicate the rationale, receive feedback, and build support before the law is taken to Parliament and implemented.

Below, we show the tax schedule for a regime with

- A buildings tax exemption threshold of RWF 5 million;
- A buildings tax rate of 0.5% above the threshold;
- A value-based land tax of 0.6% on plots above the 'standard' size, and 0.3% on the standard size.

Fixed Asset Value (RWF)	Tax Due RWF	Fixed Asset Tax Rate
3,000,000	5,850	**0.20%**
10,000,000	19,500	**0.20%**
15,000,000	29,250	**0.20%**
20,000,000	49,000	**0.25%**
30,000,000	98,500	**0.33%**
40,000,000	148,000	**0.37%**
50,000,000	197,500	**0.40%**
60,000,000	247,000	**0.41%**
80,000,000	346,000	**0.43%**
100,000,000	445,000	**0.45%**
120,000,000	544,000	**0.45%**
150,000,000	692,500	**0.46%**

The regime is projected to increase tax revenues by approximately 55%, compared to 2015/16 collections. With an exemption threshold at RWF 10m, expected revenues increased by approximately 45%. Because of the move to a value-based system, such increases will rely on accurate reference prices for audits, ensured by removing taxes on reported transaction price and conducting a mass valuation of urban land and properties.

Motivation

The purpose of this note is to advise on an appropriate building tax rate for Rwanda. *This paper reflects the analysis and opinion of the author's, and may not reflect government opinion or government policy.*

Rwanda aims that by 2020, 35% of its residents will live in urban areas (MINECOFIN, 2000), with the virtuous agglomeration economies of cities driving national economic growth and job creation. This will require heavy and sustained investment- in urban infrastructure, education and skills, and agricultural productivity to feed the urban workforce while keeping urban in-migration in check.

In contrast to their dynamic East Asian counterparts (Figure 3), many countries in Sub-Saharan Africa have urbanised with very low or even negative income growth (Figure 4 - Figure 5). People in Africa often moved to cities because of desperate rural poverty, before the human capital, urban infrastructure, and economic intensity necessary for flourishing cities had been developed, leading to low-productivity urbanisation, and the 'demons of density'- congestion, contagion, and crime.

Figure 3. ***Urbanisation was Accompanied by Strong Per Capita Income Grew in East Asia and the Pacific, 1985-2010***
(bottom of arrow 1985, top of arrow 2010)

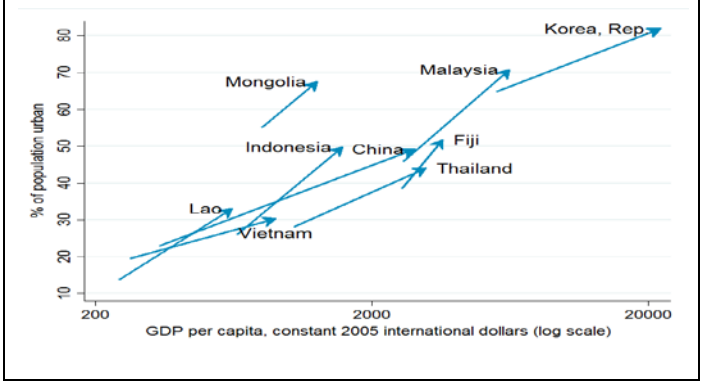


Figure 4. ***Urbanisation in Sub-Saharan Africa was Often Not Accompanied by Income Growth, 1985-2010***
(bottom of arrow 1985, top of arrow 2010)

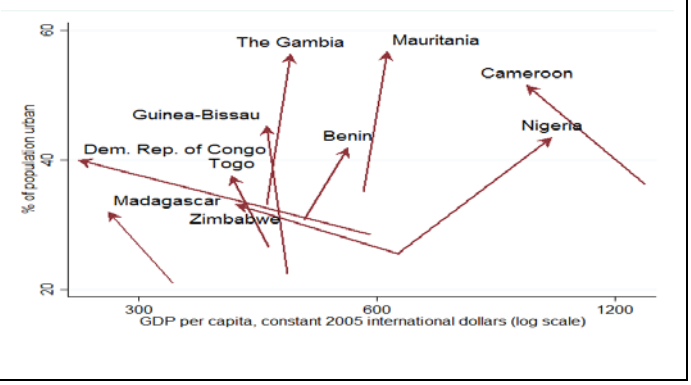


Figure 5. ***Per Capita GDP and Urbanisation in Sub-Saharan Africa: Urbanisation has Soared even while GDP Stagnated***

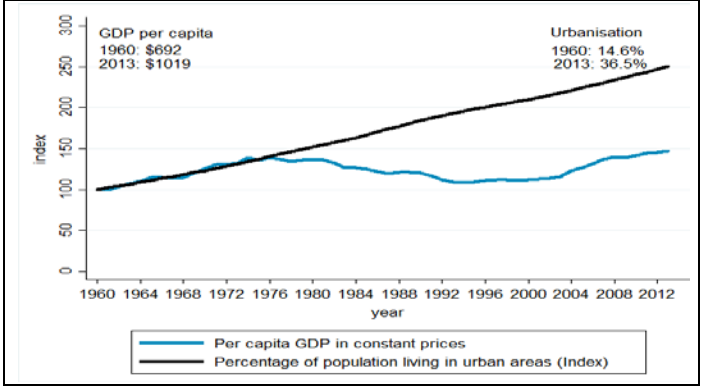
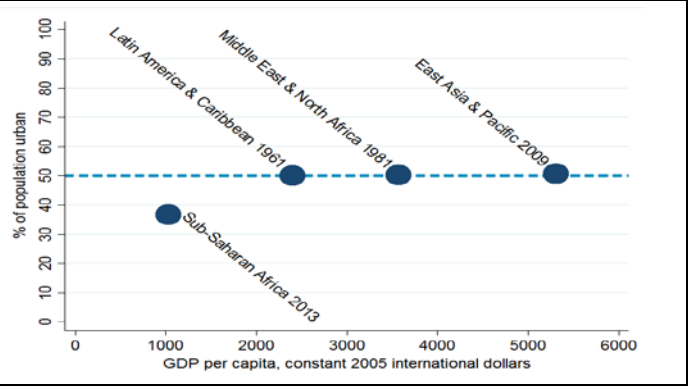


Figure 6. ***Other Regions Reached 50% Urbanisation at Higher Levels of GDP per Capita than Expected in Sub-Saharan Africa***



Source: Author's own, using World Bank Open Data, based on The Economist's (2012) graph entitled, "The Urbanisation Trap". (Figure 3-Figure 4) Author's replication of Annez, Buckley, & Spence (2009), using World Bank Open Data (Figure 5-Figure 6).

In Rwanda's cities (and particularly Kigali), public investment has been high, delivering possibly the greenest, least congested, safest city in Africa. But a sustainable revenue stream for this investment has not been secured, threatening the city's long term prospects. The fruits of recent public investment have driven land prices up from rock bottom in the early 2000s to tens of millions of francs per plot today, yet

these gains flow mostly to landlords. In 2015/16, land fees and property taxes comprised just 1% of total tax revenues, compared to upwards of 8% in the East Asian developmental states.[2] Kigali is by far the richest part of the country, yet it relies heavily on central government transfers.

Box 1. Ouroboros Illustration, 10th-11th Century AD

Ouroboros, the 'snake eating its own tail', is a symbol dating back to the 14th Century BCE, which symbolises self-sufficiency. The snake receives all the sustenance needed to grow and survive from its own tail. In many myths, the snake grows until it circles the earth. It is referenced in Ancient Egyptian, Greek, South American, Indian, and Norse mythology.

The East Asian developmental states made property- and especially land- taxes central to their development strategies: They saw that investments in urban infrastructure are expensive, but translate directly into increases in land and property values. A tax that captures those elevated land values for reinvestment creates a sustainable income stream for urban development, unlocking a virtuous cycle of self-financing urbanisation. It is not uncommon, internationally, for the combined effects of public infrastructure investment and in-migration from rural areas to appreciate urban land values ten to twenty fold in less than a decade. For example, in Seoul, South Korea, land prices rose 33-fold between 1974 and 1996.[3] In Kigali, infrastructure and in-migration (the population has more than doubled since 2000) has led to even higher land value appreciation: parcels in peri-urban areas like Kibagabaga and Kagugu, which in the early 2000s were deemed 'forests' and sold for RWF 30,000 or less, by 2010 were speculatively sold for RWF 1 million or so, and today sell for RWF 10-40 million for middle and upper-class estates. Similar exponential price trends are beginning to emerge in new neighborhoods like Batsinda, Kinyinya, and Ndera.

In East Asia, taxes on land were used not only to unlock this cycle of self-financing urbanisation, but also to align investors' incentives with the manufacturing sector, rather land speculation. While property and land taxes were high, taxes on productive sectors were typically *lower* than those seen today in Rwanda and other African countries today; final tax/GDP ratios were similar to those in contemporary Sub-Saharan Africa.

In Kigali, despite extremely high mortgage interest rates and reliance on expensive imported construction materials, sharply rising land prices and low taxes have kept urban real estate the investment sector of choice for many. 73% of investment from the top ten domestic investors in 2006-10 was in real estate or construction, and from 2006-2013, the compound annual growth of the construction sector was 19.7%, compared to just 3.3% in the manufacturing sector.[4]

The on-going decentralised taxes reform reflects the political will to resolve the weaknesses in Rwanda's land and property tax system, and to ensure that national goals for urban and off-farm development materialise on the ground. This note explains how tweaks to the current draft law- to ensure Rwanda arrives at an appropriate final effective tax rate- can help ensure these intentions are realised.

[2] In Singapore, property taxes are 8% of national tax revenue; in Taiwan by 1975, property-related taxes were responsible for 70% of local government collections; and in South Korea, by the year 2000, property taxes comprised a higher proportion of tax revenue than in any other OECD country (Goodfellow, forthcoming, "Taxing Property in a Neo-Developmental State"). In high-income countries, property taxes are typically around 4.5% of GDP.
[3] Ibid.
[4] Ibid.

Aims of the Decentralised Taxes Reform

The government's hopes for the current Decentralised Taxes reform are threefold:

1. Increase **tax revenues** substantially.
2. Broaden the **tax base** for the fixed asset tax.
3. Resolve weaknesses in **tax administration**.

This can be achieved with reference to four basic principles of an effective tax regime:

- Basic Principle 1: A good tax system includes a *broad tax base* and *low tax rate*. With a narrow tax base, an unacceptably high jump (and final level) of the tax rate is required in order to meet national financing needs, and tax revenue becomes less stable.
- Basic Principle 2: The tax base and tax rate can only be assessed together. A 1% rate could be appropriate with one base, and too low or too high with another tax base. In Rwanda's case, the fixed asset tax base is most importantly affected by the *exemption threshold* (RWF building value) for the buildings tax.
- Basic Principle 3: Normally, the tax base should be defined first, and secondly policy-makers should decide how much they wish to collect from the tax. The tax rate should be set accordingly, using simulation to determine the rate necessary to achieve the desired revenue from the given base. This may be an iterative process, in which bases and revenue targets are revised according to the results of simulation.
- Basic Principle 4: Tax simplicity is important. This suggests aiming for a small number of tax brackets (e.g., 2-3), minimising the number of taxes applied to a single asset or income stream, and having a watertight and well-communicated system for determining people's obligations.

To assess how far different reforms will achieve these aims, it is necessary first to outline Rwanda's starting point- the old fixed asset and land lease fee regimes.

'Fixed Asset Tax'

Property owners with a freehold title paid a 'fixed asset tax' (FAT) of 0.1% of the value of the land plus building ('property value'). It was hoped that people would aspire to hold a freehold title, and thus graduate to the fixed asset tax from the land lease fee over time. However, this graduation mostly did not occur, and 97% of property and land owners remained without a freehold title; in 2015/16, only 2,000 paid the fixed asset tax. The revenues from this tax were just RWF 0.5 billion in 2015/16 (less than a million dollars). Revenues have recently been collected by the Rwanda Revenue Authority, though continue to be transmitted back to local governments. Data suggest that those paying under the fixed asset tax regime were generally that portion of richer land and property-owners for whom a 0.1% fixed asset tax was lower than their alternative land lease fee (Figure X, below); several poorer property-owners would have profited from the regime, but could not qualify for a freehold title.

Land Lease Fee

Most urban residents were liable for the 'land lease fee' (LLF), which taxed solely the land underneath the property (buildings were untaxed, and land lease payers were exempt from the fixed asset tax). Revenues from the land lease fee were approximately RWF 4.4 billion in 2015/16.[5] Land lease fees ranged from RWF 0-80/m^2 for urban plots, equivalent to 0-3% of total fixed asset values for most tax-payers. 40% of plot were liable for land lease fees above 1% of land values (these were almost always low-value plots- see **Error! Reference source not found.**). Properties worth above RWF 40 million rarely paid more than 0.1% effective tax rate (suggesting that those with the means switched to the 'safe haven' of the fixed asset tax if land lease fee payments would be higher). The low cap on the land lease fee (RWF 80/m^2), the exclusion

[5] Land lease fees collected August 17 2015 – August 17 2016. Source: RRA Decentralised Taxes Database.

of building values from the tax, and the lack of information available to help districts assign proportionate fees to plots, meant that this tax was often highly regressive, with the lowest-value plots facing the highest effective tax rates. (***Figure 1***, Executive Summary).

In practice, fees were often not collected from the lowest-income land-owners, due to their inability to pay. However, all taxes (and any accruing fines) must be paid before a fixed asset can be legally transferred, meaning this inability to pay the land lease fee is likely to be inducing informal transactions, or preventing poor land-owners from selling their plots.

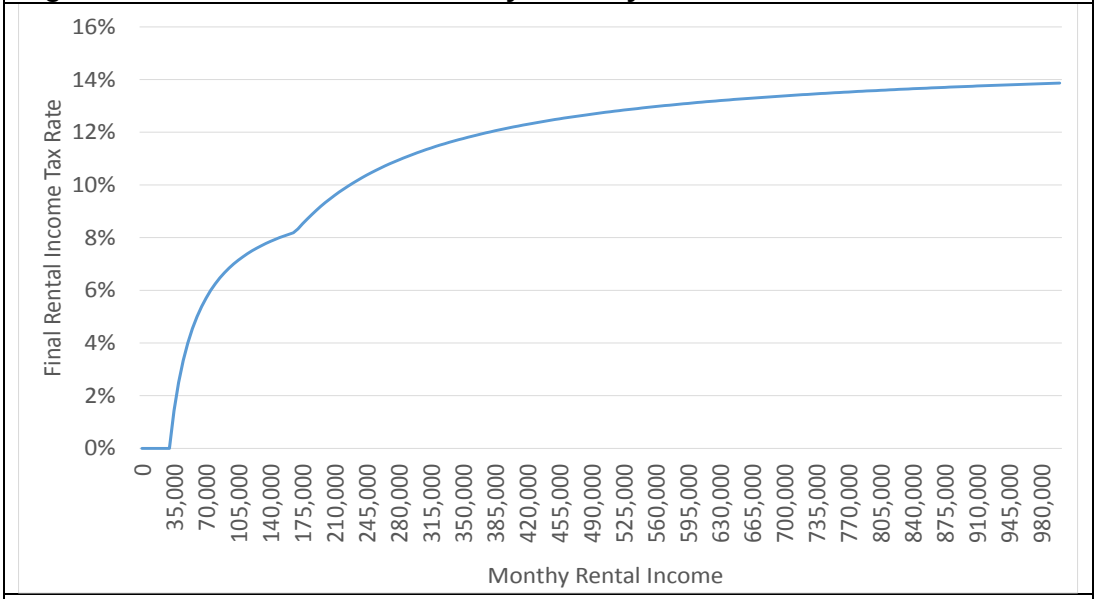
Like the fixed asset tax, land lease fees have recently been collected by the Rwanda Revenue Authority, and are transmitted back to local governments.

Other Taxes on Property

Properties rented to tenants were also liable for rental income tax, and at high levels of income, Value Added Tax (VAT).

A typical rental income tax rate in the region is 10%.[6] Rwanda's system is more progressive than most: rental income tax is 0% for the portion received up to RWF 0-30,000 per month, 10% on the portion between RWF 30,000 and RWF 167,000, and 15% on any remaining (higher) rental income.[7] The total rental income tax paid, as a proportion of total rental income (i.e., the 'effective tax rate') reaches the 'standard' 10% rate at rental incomes of RWF 240,000 per month, and was lower below and higher above this figure (**Figure 7**). Thus, Rwanda's rental income tax is generally in line with those of neighbouring and other countries, except it is more progressive, and the highest-earners may pay up to 5 percentage points more than those in other countries.

Figure 7. Rental Income Tax Rate by Monthly Rental Income



This graph shows the rental income tax rate by monthly rental income. Those receiving less than RWF 30,000 pay 0%, those receiving RWF 30,001-83,333 pay 0-8%, and those receiving more than RWF 83,333 pay 8-15% of their total

[6] E.g. Kenya: http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/FinanceActNo14of2015.pdf, Tanzania: http://www.tra.go.tz/publications/Taxes%20and%20Duties.pdf, Uganda proposed 12% in 2014: https://www.pwc.com/ug/en/assets/pdf/taxwatch-budget2015.pdf

[7] The wording of the income tax schedule is different in the law: actual rental income received is halved, and the remaining portion is treated as rental income for tax purposes. Of that remaining 50%, the first RWF 15,000 is not taxed, the portion from RWF 15,000 to RWF 83,333 is taxed at 20% (equivalent to 10% of actual rental income), and any higher rental income is taxed at 30% (equivalent to 15% of actual rental income). The law also states the brackets in annual terms, rather than monthly; these are here converted to improve comprehension.

rental income in tax.

The New Draft Law in Brief

The new Local Taxes (Umushinga) Law, and Taxes on Income Law, would apply three taxes to land and property in Rwanda, the first two of which combine to constitute the new 'fixed asset tax':

1. Tax on Buildings (previous 'Fixed Asset Tax')
2. Tax on Land (previously 'Land Lease Fee')
3. Sales Tax (a new tax)

Below we describe, and then comment on, each component, with reference to the government's aims for the reform, and the four principles of an effective tax regime.

Section 1. Tax on Buildings

Description of the Tax

The tax on buildings is a local government tax, and part of the new 'fixed asset tax'. Under the current draft law, it would charge 0.2% of the value of any *buildings* after subtracting an 'affordable housing' price - that is, it charges the building value *minus the threshold*, multiplied by 0.002. The exemption threshold is to be determined by a later Ministerial Order from the Ministry of Infrastructure (MININFRA), so that the price can be updated more easily as building values rise; MINECOFIN will advise strongly on the value this threshold should take.[8]

The key deviations from the old 'fixed asset tax' are thus as follows:

1. Tax liability is not determined by the type of *title* held, but instead by the value of one's building; thus the previous broad legal exemption is eliminated.
2. The tax rate is applied to a *much smaller* portion of the property value (typically 0-30%). Specifically, the land, and (large) portion of the building value that falls below the 'affordable housing' threshold, are not taxed.
3. The face-value tax rate is doubled, from 0.1% to 0.2%.

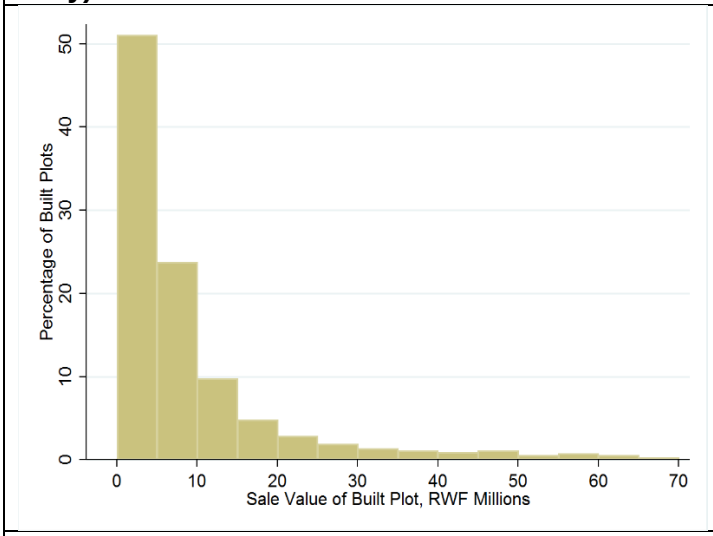
[8] Since the exemption concerns the *structure* value, the Order will details the affordable structure value separately from the affordable land value

Expanding the tax base adequately requires a lower exemption threshold. A driving motivation behind this reform is to expand the base for buildings-related taxes, from a starting point of just 2,000 property-owners. The extent to which this goal is met will depend critically on the exemption threshold established. Currently policy-makers favour a threshold of RWF 30 million. This would exclude approximately 94% of property-owners, compared to 97% excluded under the previous FAT. It also excludes a large portion of the *value* of the remaining properties, by excluding building value below the 'affordable housing' threshold.

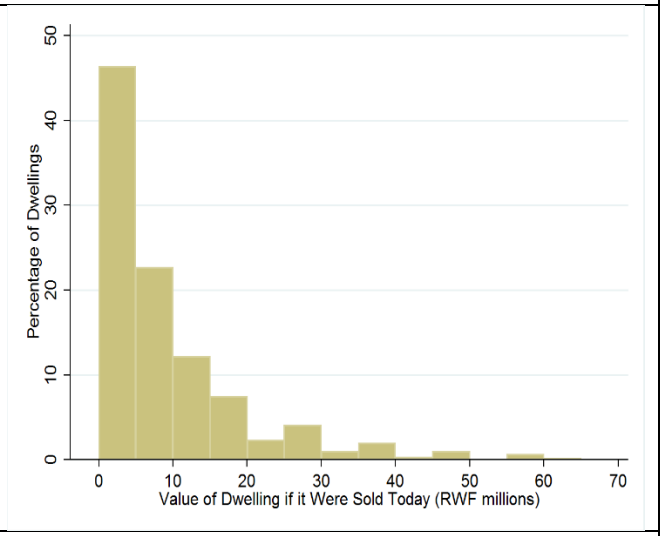
Figure 8 shows the distribution of properties by price in Kigali. The graph on the left uses LAIS transaction data from Kigali in 2015/16; it only includes built plots, and combines commercial and residential buildings. The graph to the right uses EICV4 data from Kigali, so only includes residential homes.

Figure 8. Histograms to Show The Percentage of Properties in Kigali with Various Values

b. LAIS 2015/16 Transaction Data (Built Plots Only)



b. EICV4 (2012) Data (Dwellings Only)



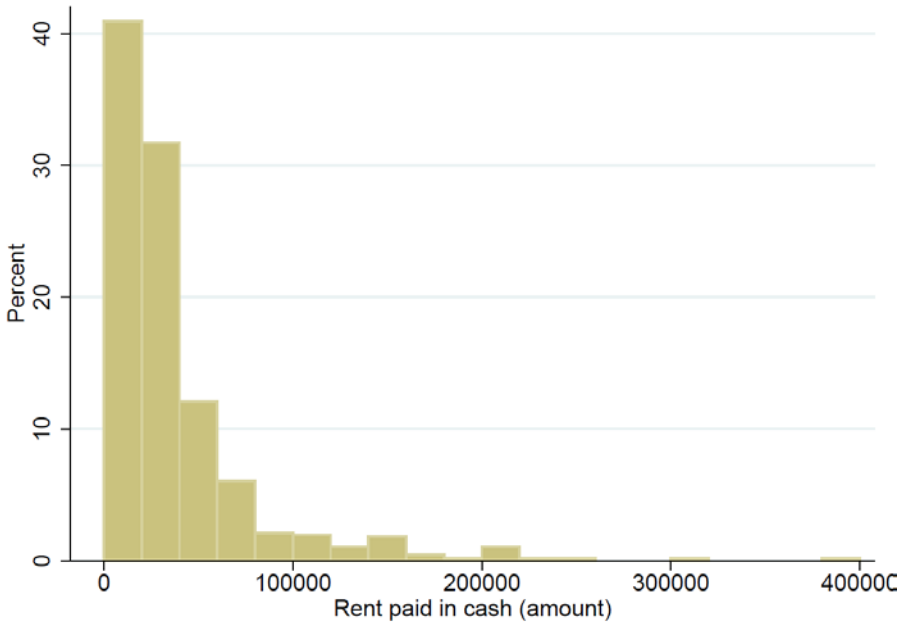
Both LAIS transaction data (above left) and EICV4 data (above right) show a similar spread of property values. The strong agreement between the two independent data sources suggests the data is quite accurate overall. 70% of values are below RWF 10 million, implying building-only values below RWF 6.6 million. (Land is typically 30-50% of total property value)

The graphs are in strong agreement on the spread of prices. In both data sets, the proportion of properties worth more than RWF 45 million (implying building values of RWF 30 million or more)[9] is less than 6%,[10] which may entail approximately 10-15,000 properties.[11]

The broad agreement between the data plotted above suggests that it is generally accurate. However, even if people are tactically under-reporting property values, these reported values will nonetheless form the basis of any property value roll and will be the values against which taxes are levied.

Figure 9. Monthy Rent Payments in Kigali (EICV4)

[9] Buildings are typically two thirds of property value, land constituting the final third. As land values rise and buildings depreciate, the ratio becomes closer to 50:50.
[10] The figure is 4% in EICV4 and 6% in the LAIS data. The LAIS figure is likely higher because it includes commercial buildings.
[11] There is no good data on the number of properties in Kigali, but there are 390,000 plots, approximately two thirds of which may be built (261,000 built plots). 261,000 x 0.006=15,678



We look to the housing rental market as a final check for our property price estimates. 75% of renters in Kigali report paying less than RWF 50,000 per month- an amount that implies a property value of approximately RWF 7.2 million, and a building-only value of RWF 4.8 million. This supports the above conclusion that 70% of properties in Kigali are worth less than RWF 10 million, and buildings worth less than RWF 7 million.

Table 2 below shows the proportion of property owners that the government can expect to reach with the buildings tax under different exemption thresholds.

Table 2. What Proportion of Property Owners in Kigali Are Liable for Building Tax Under Different Exemption Thresholds?

Exemption Threshold *(Price of Building Only)*	**Implied Total Property Value** *(Adds land value at half building value)*	**% of properties in building tax base**	
		LAIS data	**EICV4 data**
RWF 3 million	RWF 4.5 million	56%	62%
RWF 5 million	RWF 7.5 million	37%	46%
RWF 10 million	RWF 15 million	19%	21%
RWF 15 million	RWF 21.5 million	13%	13%
RWF 20 million	RWF 30 million	9%	7%
RWF 30 million	RWF 45 million	6%	4%

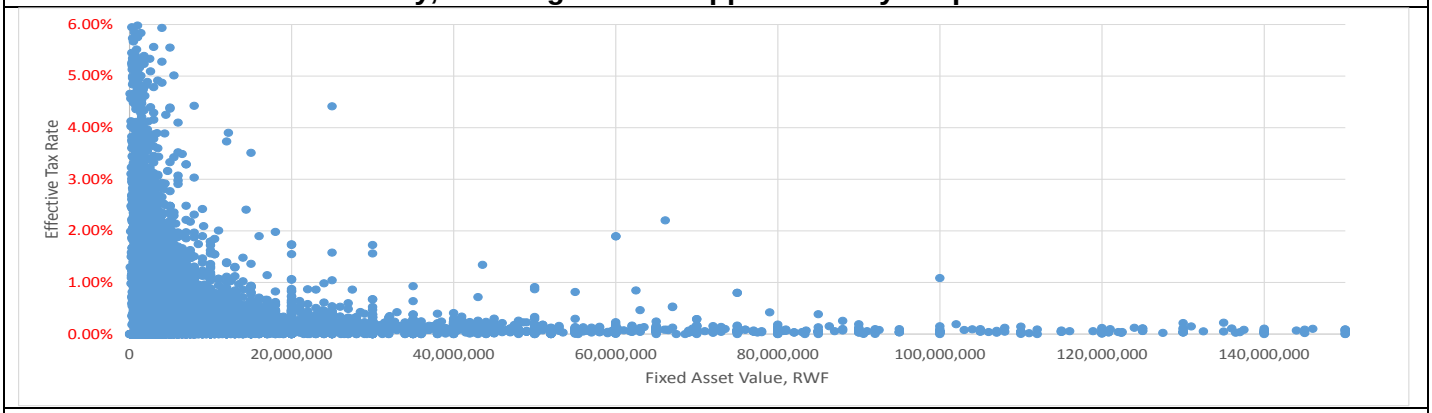
A broader building tax base improves the progressiveness of the FAT. For most tax-payers, the largest burden has come, and will continue to come, from land taxes, on which there is no value-based exemption threshold. Since the land tax is highly regressive (**Figure 10**), and the buildings tax progressive, lowering the building tax threshold would improve the progressiveness of the fixed asset tax overall, by increasing the rates paid by wealthier property-owners closer to those paid by on less valuable plots.

This is modelled in **Figure 10**, in which (Panels a-d) the building tax exemption threshold is gradually lowered, and the buildings tax rate increased, making the overall regime more progressive as one moves down the page. Panel a shows the land lease fee only (no buildings tax), which constitutes a highly regressive regime where the highest rates are paid against the least valuable plots. Panel b introduces a 0.2% buildings tax on values above RWF 30 million; following this change, the fixed asset tax becomes progressive for properties valued above RWF 40 million. With the threshold lowered to RWF 6 million (Panel c), the regime becomes progressive from around RWF 25 million. And if the rate is increased to 0.7%, the regime is progressive for properties above approximately RWF 18 million.[12]

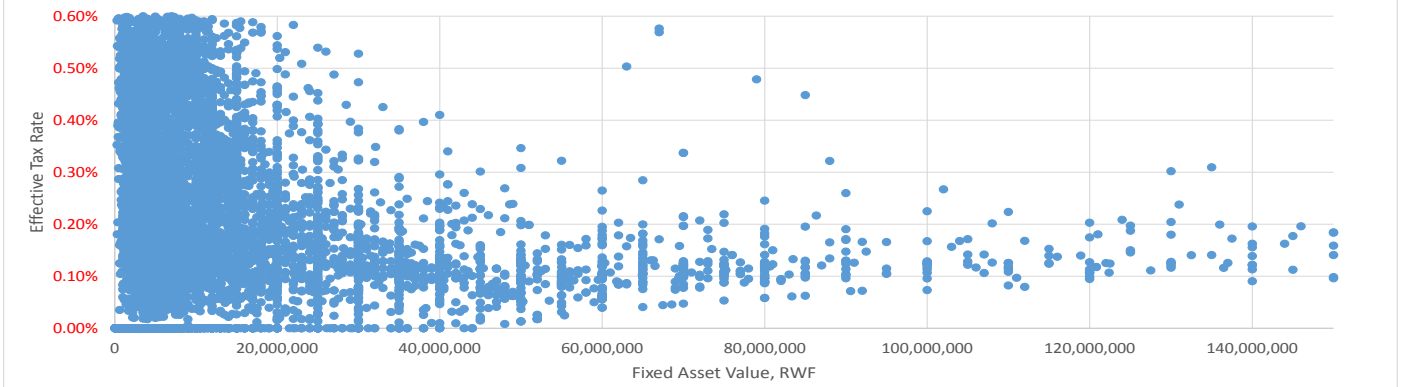
[12] The data on property values comes from the LAIS, and shows the 13,000 plots that were transacted in Kigali in 2015/16. Land lease fee liabilities are inferred from the registered land use of each plot, village, and m^2 area, according to the District council decrees on land tax rates.

Figure 10. The Effective Tax Rate by Property Value Becomes More Progressive as the Threshold Shifts Left (Lowers) and the Rate Rises

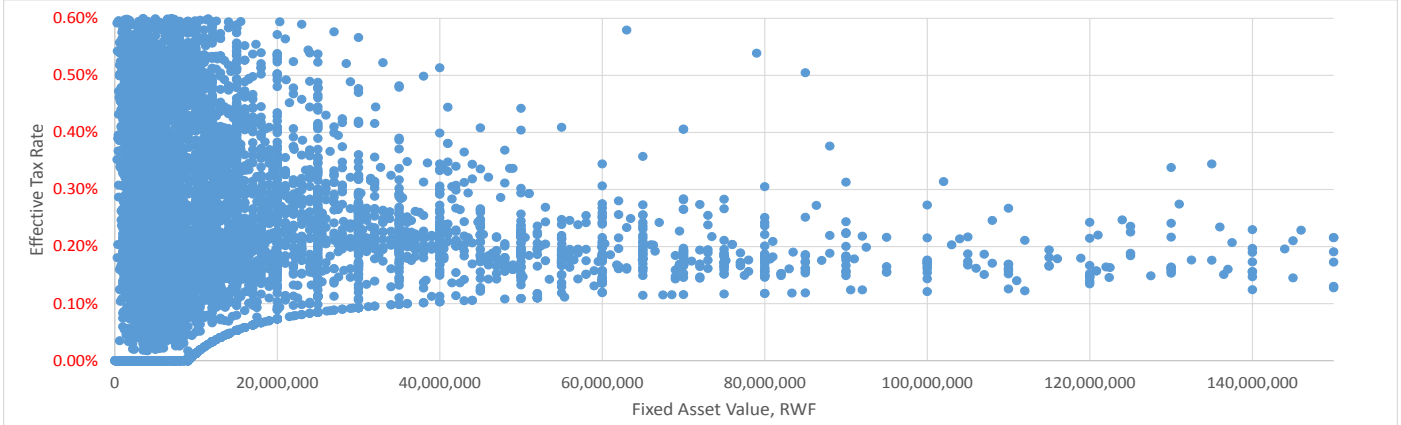
Panel a. Land Lease Fee Only, Building Tax Not Applied to Any Properties



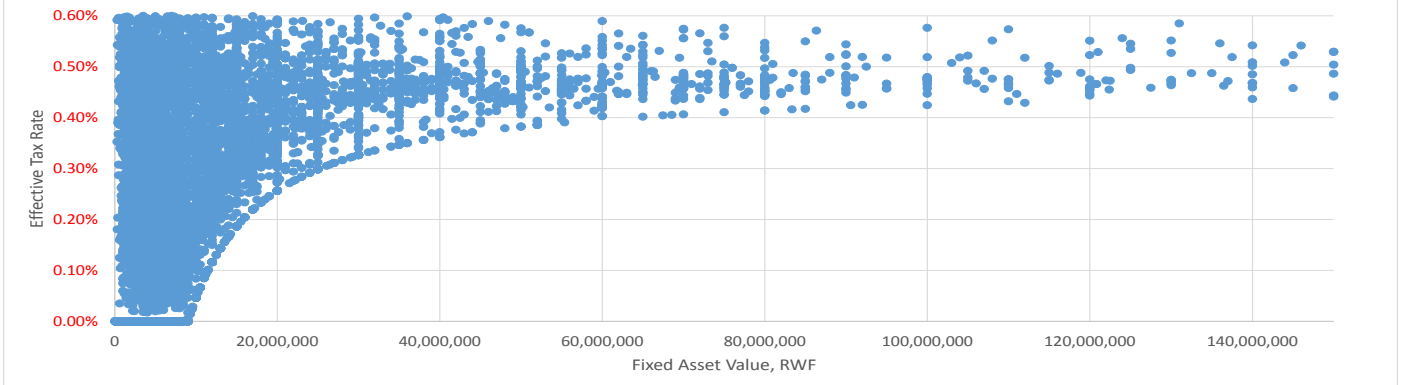
Panel b. Land Lease Fee Plus Buildings Tax Above RWF 30 Million, at 0.2%



Panel c. Land Lease Fee Plus Buildings Tax Above RWF 6 Million, at 0.2%



Panel d. Land Lease Fee Plus Buildings Tax Above RWF 6 Million, at 0.7%



If the exemption threshold is to be called the 'affordable house' threshold, and set by MININFRA, there will be considerable pressure for it become too high. MININFRA already has policies and Instructions on affordable housing thresholds to guide implementation of instruments that target different income groups, from poor market women and day labourers, to college graduates, to mid-range civil servants. MININFRA have stated that if they set the threshold for the buildings tax, it will need to conform with their other 'affordable house' thresholds and conditions. These include:

- The Prime Minister's Instructions of 13/11/2015[13] on the conditions for obtaining support for affordable housing;
- An Instruction currently being drafted to determine the conditions under which real estate developers receive preferential income taxes;[14]
- The 'affordable house' threshold above which the Sales Tax will be levied;
- 'Affordable house' thresholds to determine developers' access to the Urban Infrastructure Fund subsidies.

Although MININFRA are a key partner in housing, and should be strongly consulted, calling the threshold an 'affordable house' rate, and assigning responsibility for setting it to MININFRA, severely limits policy freedom to select the an effective threshold for the buildings tax.

Recommendations

- Rather than start with a RWF value threshold, the government should decide first what proportion of property-owners they wish to reach with the buildings tax, and working backwards to select the appropriate exemption threshold, using the table above.
- Remove the title 'affordable housing' from the threshold, so it needn't follow inappropriate precedents from other laws targeting different groups and instruments;
- Leave responsibility for setting the threshold with RRA or MINECOFIN, given its huge impact on the final tax schedule and revenues, which are of greater relevance to MINECOFIN.

[13] Prime Minister's instructions No 004/03 of 13/11/2015

[14] " Ministerial Instructions Defining the Criteria for Investors Registered in Building Low-Cost Housing to Obtain the Right to Apply Preferential Income Tax Rates"

Basic Principle 2: The Tax Base and Tax Rate Must be Assessed Together

Analysis

The face-value building tax rate is not the same as the fixed asset tax rate. The cabinet paper describing the proposed draft law stated that, "in this draft law, the [fixed asset] tax rate was increased from 0.1% to 0.2% of the market value of a fixed asset." This is also how the building tax was described in consultation meetings. However, this does not correctly describe the change from the FAT to the new buildings tax.

Under the earlier FAT, the rate (0.1%) was applied to the *full market value* of the fixed asset. Under the new regime:

i) The building tax is applied *only to the building value*, not the land value.
ii) It is also applied only to the value of the building *above the exemption threshold*, not the full market value of the building.

Box 2. Calculating Buildings Tax Due and the Effective Tax Rate in the Draft Law

	RWF 60 million	(Market value of fixed asset)
Subtract	RWF 20 million	(Land value)
Subtract	RWF 30 million	(Portion of building value exempt)
Equals	RWF 10 million	(Taxable value)
	RWF 10 million	(Taxable value)
Multiplied by	0.002	(Buildings tax rate)
Equals	RWF 20,000	(Buildings tax due)
	RWF 20,000	(Tax due)
Divided by	RWF 60 million	(Market value of fixed asset)

The tax rate on the market value of a fixed asset is thus *not the same as* the face-value building tax rate. Consider a RWF 60 million property, with land worth RWF 20 million and a building worth RWF 40 million (**Box 2**). Under the old regime, this property owner paid 0.1% of RWF 60 million: RWF 60,000. Under a 0.2% tax "on the market value of the fixed asset", she would pay RWF 120,000. Under the draft law, they would instead pay RWF 20,000 in buildings tax. That is, a 70% *reduction* on the amount due under the previous fixed asset tax (FAT).

The FAT payers would, however, also face a new obligation under the land tax. Our data from 13,000 plots in Kigali in 2015/16,[15] shows that land lease fees were more than 0.1% of fixed asset values for 60% of the properties. However, properties under the Fixed Asset Tax were typically higher-value properties, which faced lower effective tax rates from the land lease fee. Properties worth over RWF 45 million were typically liable for *less than* 0.1% in land lease fees 75% of the time; given the low rate of the buildings tax, many of these would also pay less under the proposed regime. **Figure 11** shows land lease fees as a percentage of fixed asset values, for fixed assets priced at over RWF 45 million in our sample.

If the land tax were effectively reformed to approximate a 1% land value tax for all, this would approximate 0.3-0.5% of the total fixed asset values, more than tripling the tax due from previous FAT payers.

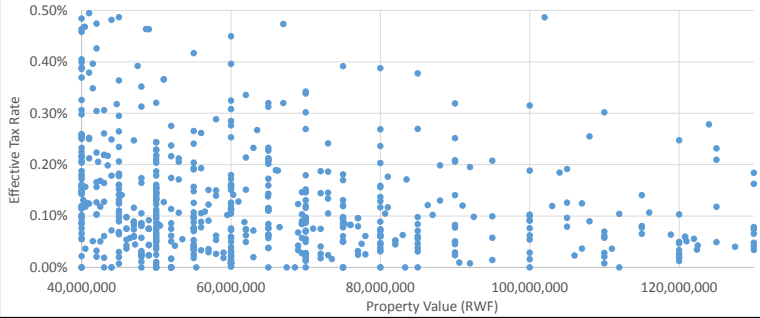
It is worth briefly viewing the question of the tax base and tax rate with a 'wide angle lens', not only considering payments called 'taxes', but also local 'fees'. Most residents have been paying several local fees in aid of to neighbourhood improvement in addition to the land lease fees: garbage collection and

[15] From land transactions in RNRA's LAIS and District land lease fee schedules.

cleaning, neighbourhood security, 'voluntary' contributions to school/path/road building, and well as 'in-kind' contributions during *umuganda*.

Many of these fees, though graduated somewhat by income, represent a much larger proportion of the incomes of the poor. For example, fees for garbage collection and security in Kigali are often RWF 1,500 per month for lower-income residents (residents earning RWF 30-60,000 per month), and closer to RWF 5,000 per month for richer residents (often earning RWF 500,000-RWF 1.5 million per month); this results in payments equivalent to 3-5% of income[16] for poorer residents, and 0.5% or less for those with greater means. In Kigali in 2015/16, revenue from fees was fourteen times the revenue from property taxes.[17] There is an argument for the *overall* burden of neighbourhood improvement fees and taxes to be equalised as a proportion of wealth and income, with middle-class property owners at least moving closer to a 1% contribution, and even for consideration of revising downwards the fees paid by lower-income residents.

Figure 11. Effective Tax Rate of the Land Lease Fee, for Properties Liable for Proposed Buildings Tax



This graph shows the land lease fee obligations (y axis) as a percentage of fixed asset values (x axis) for properties that would be liable for buildings taxes under the new regime. Although the sample is small, it shows most paying under 0.15%.

The table below illustrates this point with some case study properties. If the exemption threshold is set at RWF 30 million and the building tax rate at 0.2%, actual buildings tax payments range from RWF 0 – RWF 20,000 for the vast majority of taxpayers. Effective tax rates *from the buildings tax* are far *lower* than the previous 0.1%. This is positive, in so far as land-owners are not penalised for making effective use of their land (building valuable properties). It is negative in that the regime is less progressive when the (regressive) land tax dominating everyone's obligations, and because hardly any revenue is collected from the substantial (half to two thirds of) value held in buildings.

Table 3. Case Study: Four Properties Under a 0.2% Rate and RWF 30 million Building Exemption Threshold

Total Property Value	Of Which Land	Of Which Building	Taxable Value *(Building Value Minus Exemption)*	Building Tax Due *(0.2%*Taxable Value)*	Effective Tax Rate from BT *(Building Tax Due/Total Value)*
RWF 15 million	RWF 5 million	RWF 10 million	RWF 0	RWF 0	0%
RWF 30 million	RWF 10 million	RWF 20 million	RWF 0	RWF 0	0%
RWF 60 million	RWF 20 million	RWF 40 million	RWF 10 million	RWF 20,000	0.03% (A thirtieth of one percent)
RWF 120 million	RWF 40 million	RWF 80 million	RWF 50 million	RWF 100,000	0.08% (A twelfth of one percent)

In **Table 4** to **Table 6** we show the tax liabilities and effective tax rates resulting from alternative thresholds and rates. In the final column of each table, we model a reformed land tax that approximates 1% of land

[16] 1-2% of property values.
[17] Data from RRA Decentralised Taxes Department, for July 2015-June 2016.

values and show its impact on final effective tax rates, in case this is a longer-term goal of the government. This dominates the building tax revenues.

In the spreadsheet tool accompanying this paper, users can model the effective tax rates and taxes due from any combination of rates and schedules.

Recommendations

- The exemption threshold should be set bearing in mind that those with properties 'just above' the threshold will still pay very little in building tax, since only the *extra* value *above the threshold* is taxed. This is something that hasn't been communicated clearly so far, and as shown above, creates a big difference between the face-value buildings tax rate and the real effective tax rate.
- Under the old regime, low-income property-owners tended to be liable for 0.3-2% effective tax rate in land lease fees (their burden becomes even higher when other fees like garbage, cleaning, security, and so on, are considered). This seems likely to continue, or worsen, in the new regime. From a fairness perspective, property-owners with greater means should at least be brought up to a similar final effective tax rate.
- The land tax will continue to constitute a large part of tax-payers' fixed asset tax burdens and source of government revenues. Commensurate care should be taken to get this right. (Section 3 of this paper discussed the land tax.)
- In communicating and assessing regimes, policy-makers should note that most property-owners previously paid the land lease fee, which was typically higher than the fixed asset tax. Any rise in the tax rate is from a base of 0.1-0.6% (land lease fee equivalent rates) for richer property owners, rather than 0% or 0.1%.
- Former fixed asset tax payers paid 0.1% on the *total* value of their property, whereas the new buildings tax excludes land, and any value below the exemption threshold. In communicating the new regime, this 0.1% should thus be directly compared with the new *effective tax rate*, not with the *face-value* buildings tax rate, which is very different.

Table 4. Case Study: Four Properties Under a 0.2% Rate and RWF 10 million Building Exemption Threshold

Total Property Value	Of Which Land	Of Which Building	Taxable Value *(Building Value Minus Exemption)*	Building Tax Due *(0.2%*Taxable Value)*	**Effective BT Tax Rate** (*Building Tax Due/Total Value)*	Final Effective Tax Rate, BT + LT *(Assumes 1% land tax)*
RWF 15 million	RWF 5 million	RWF 10 million	RWF 0	RWF 0	**0%**	0.3%
RWF 30 million	RWF 10 million	RWF 20 million	RWF 10 million	RWF 20,000	**0.067%** *(A fifteenth of one percent)*	0.367%
RWF 60 million	RWF 20 million	RWF 40 million	RWF 30 million	RWF 60,000	**0.1%** *(A tenth of one percent)*	0.4%
RWF 120 million	RWF 40 million	RWF 80 million	RWF 70 million	RWF 140,000	**0.12%** *(An eighth of one percent)*	0.42%

Table 5. Case Study: Four Properties Under a 1% Rate and RWF 10 million Building Exemption Threshold

Total Property Value	Of Which Land	Of Which Building	Taxable Value *(Building Value Minus Exemption)*	Building Tax Due *(1%*Taxable Value)*	**Effective BT Tax Rate** (*Building Tax Due/Total FAT Value)*	Final Effective Tax Rate, BT+LT *(Assumes 1% land tax)*
RWF 15 million	RWF 5 million	RWF 10 million	RWF 0	RWF 0	**0%**	0.3%
RWF 30 million	RWF 10 million	RWF 20 million	RWF 10 million	RWF 100,000	**0.3%** *(A third of one percent)*	0.6%
RWF 60 million	RWF 20 million	RWF 40 million	RWF 30 million	RWF 300,000	**0.5%** *(Half of one percent)*	0.8%
RWF 120 million	RWF 40 million	RWF 80 million	RWF 70 million	RWF 700,000	**0.58%** *(Five sixths of one percent)*	0.88%

Table 6. Case Study: Four Properties Under a 0.6% Rate and RWF 10 million Building Exemption Threshold

Total Property Value	Of Which Land	Of Which Building	Taxable Value *(Building Value Minus Exemption)*	Building Tax Due *(0.6%*Taxable Value)*	**Effective BT Tax Rate** (*Building Tax Due/Total Value)*	Final Effective Tax Rate, BT + Land Tax *(Assumes 1% land tax)*
RWF 15 million	RWF 5 million	RWF 10 million	RWF 0	RWF 0	**0%**	0.3%
RWF 30 million	RWF 10 million	RWF 20 million	RWF 10 million	RWF 60,000	**0.2%** *(A fifth of one percent)*	0.5%
RWF 60 million	RWF 20 million	RWF 40 million	RWF 30 million	RWF 180,000	**0.3%** *(Three tenths of 1 percent)*	0.6%
RWF 120	RWF 40	RWF 80	RWF 70	RWF 420,000	**0.35%**	0.65%

million	million	million	million		*(A third of one percent)*	

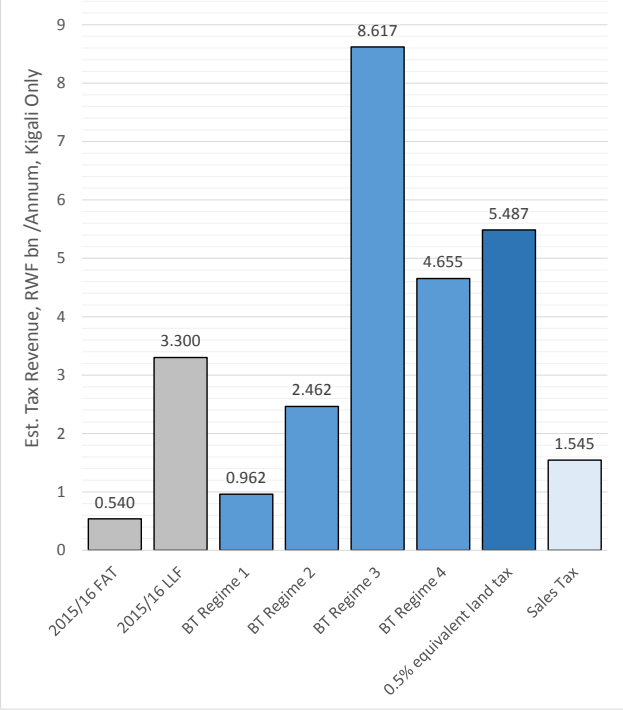
Basic Principle 3: Set a Revenue Target and Tax Base, then Compute the Required Rate

Analysis

Revenues from the previous Fixed Asset Tax were RWF 540 million, and revenues from the Land Lease Fee RWF 4.3 billion, in 2015/16- totalling RWF 4.84 billion. Usually, rates should be set considering the revenue target for a tax, and the desired tax base. MINECOFIN has no particular revenue target for the new regime (a weakness). However, the increase should be sufficient to protect the sustainability of necessary urban spending for the next five years until the law may be revised. Tripling revenues - to RWF 14 billion- may be a suitable initial target.

The spreadsheet tool accompanying this paper allows policy-makers to simulate the revenues from different regimes of interest, changing the parameters of the land tax regime, sales tax, building tax rate and building tax exemption threshold. The example graph below (**Figure 12**) is taken from that tool, and shows approximate revenue estimates from four possible regimes, plus the land tax and sales tax, for Kigali only. It assumes 50% compliance (and that our 2015/16 transaction prices are representative for all Kigali).[18] These revenue simulations are approximate 'best estimates', useful for comparing regimes but not robust enough for setting firm revenue forecasts.

Figure 12. Revenue Projections from Different Property and Land Tax Regimes (Kigali Only)



This graphs shows 2015/16 revenues from the land lease fee and fixed asset tax, and forecasts revenues from four alternative buildings tax regimes, as well as a 0.5% land tax or 5% sales tax.

Regime Title	Exemption Threshold (Building Value)	Building Tax Rate
Building Tax (BT) Regime 1	RWF 30 million	0.2%
Building Tax (BT) Regime 2	RWF 6 million	0.2%
Building Tax (BT) Regime 3	RWF 6 million	0.7%
Building Tax (BT) Regime 4	RWF 20 million	0.7%

The graph illustrates the importance of getting both the tax rate and the tax base (exemption threshold) right. A lower exemption threshold can more than double tax revenues (Regime 2 versus Regime 1, or Regime 3 versus Regime 4), while also spreading the burden over a wider constituency. To double or triple overall fixed asset revenues (including land revenues), both a higher buildings tax rate and a wider buildings tax base are required, as well as an effective land tax.

[18] Our sample features central and sub-urban plots more than very peripheral, remote plots. Thus it likely overstates true revenue potential. However, the 50% compliance assumption is very conservative.

Basic Principle 4: Regime Simplicity

The building tax regime in the draft law has the virtue of simplicity, which is appropriate for a new tax regime with several complex moving parts. The regime has just one building tax rate, applied to all properties above the exemption threshold; this compares to the standard in other countries, whereby a different rate for industrial or commercial properties, second homes, or more valuable homes is often introduced.

If the government wishes to move towards a system with a large base and good revenues, while upholding affordability and acceptability, however, some differentiation of the buildings tax rate by property type may be helpful.

For example, it may be risky to jump straight to a face-value tax rate of 1% on buildings. The burden could be dampened for everyone, equity improved, and impediments to affordable housing reduced, by introducing *three* value brackets for the tax rather than two. To give an example: the value of any building between RWF 0 and RWF 6 million could be taxed at 0%, the portion of the value between RWF 6 million and RWF 15 million could be taxed at 0.5%, and the value above RWF 15 million could be taxed at 1%. Other rates and brackets are of course possible. The table below models this example, showing the resultant payments and tax rates for the four case study properties used earlier in the paper.

Table 7. Tax Liabilities Resulting from a 0.5% Tax on Building Values Between RWF 6-15 million, and 1% Tax on Building Values Above RWF 15 million

Total Property Value	**Of Which Land**	**Of Which Building**	**Value Taxable at 0.5%**	**Value Taxable at 1%** *(Building Value Minus 15m)*	**Total Building Tax Due**	**Effective Tax Rate from Buildings Tax** (*Building Tax / Total Fixed Asset Value)*
RWF 15 million	RWF 5 million	RWF 10 million	RWF 4 million *(RWF 20,000 tax)*	RWF 0 *(RWF 0 tax)*	RWF 20,000	**0.13%**
RWF 30 million	RWF 10 million	RWF 20 million	RWF 9 million *(RWF 45,000 tax)*	RWF 5 million *(RWF 50,000 tax)*	RWF 95,000	**0.32%**
RWF 60 million	RWF 20 million	RWF 40 million	RWF 9 million *(RWF 45,000 tax)*	RWF 25 million *(RWF 250,000 tax)*	RWF 295,000	**0.5%**
RWF 120 million	RWF 40 million	RWF 80 million	RWF 9 million *(RWF 45,000 tax)*	RWF 65 million *(RWF 650,000 tax)*	RWF 695,000	**0.58%**

Many countries apply higher rates for commercial and industrial properties, as these typically make more intensive use of land and infrastructure, and have a stronger revenue stream for paying the tax. In other countries (including neighbouring Uganda, China, and the UK), owner-occupied first homes face lower tax rates, or are exempt, to protect housing affordability. Any possible benefits from these and other nuances should be balanced against the benefits of the simplicity in the current regime and possible revenue losses; changing too many parts at once is not advisable. However, these nuances should be considered when making international comparisons.

Accurate Valuation Rolls Are Crucial

Description of the Planned Valuation Process

Accurate property valuation is essential for a good final tax schedule and revenues. In the current draft law, unless a plot or property was i) sold, or ii) valued by a certified valuer, in the past five years, building values will be derived from self-assessment. In cases where the property was sold in the past five years, the sale value reported will be taken as the property value. The RRA will commission the Institute of Real Property Valuers (IRPV) to conduct three counter-valuations in cases where self-assessed values are suspect. There is discussion of replacing this self-assessment with valuation by 'Computer Aided Mass Appraisal' (CAMA), over the short-to-medium term, though this is not currently written into the law.

Analysis

Until a CAMA is introduced, building taxes will be easy to evade through misreporting. Transaction prices and self-declared values can easily be under-stated, and there is insufficient capacity in sector offices, and insufficient data available to RRA, to credibly audit and challenge reported values. The threat of audit by RRA is low, as ***for most properties, the cost of three IRPV counter-valuations will exceed the expected revenue from the property tax for at least five years.*** The government may have to expect low revenues to continue due to under-reporting of values, while these loopholes are closed.

The CAMA would scientifically estimate property and land values for all urban plots, to enable audits or direct assignment of tax liabilities. A CAMA would ascertain how land and property prices vary by location and other characteristics, assigning data-driven estimated prices to each plot and property. It would draw on **reported transaction prices** from RNRA's LAIS, and information on the *characteristics* of land and buildings such as slope of land, floor area, roof material, infrastructure, zoning, etc. The CAMA would offer a *selection* of models to estimate the values of plots and houses, which policy-makers can chose between, according to their preferences over accuracy, simplicity, ease of data updates, etc. In most developed countries, property tax liabilities are derived directly from a similar external mass valuation process, and a mechanism is established for land/property owners to appeal if they believe these estimates to be far out. Rwanda can follow this option (this would require amending the draft law once the CAMA is complete), or RRA can use the CAMA to audit self-declared values and thus encourage truthful reporting.

Under the CAMA there is no incentive to under-report sale values at the point of transaction. A property's value is assessed based on the sale values of *similar* properties, not its *own* reported sale value. This is important, as it keeps LAIS transaction price data intact.

The regime proposed is likely to undermine valuation rolls, and thus fixed asset tax revenues. A very risky aspect of the present system is that it encourages under-reporting of sale values. These low prices will then be fed into the CAMA, leading to an under-valuation of all properties. With such under-valuation, property tax revenues will be seriously depleted. Since the CAMA should also inform the land taxes, revenues from this stream may also be greatly undermined. This is particularly important at present, as good data about property and land values in Kigali is not yet available; the LAIS has only recorded transaction values since the start of 2015, leading to a database of about 3% of properties in Kigali. Furthermore, while values are rising quickly, it's important to track these regularly, by ensuring a stream of reliable sales data.

The alternative, pure self-valuation, will of course also lead to under-reporting, but this under-reporting will crucially not interfere with the CAMA, and will also only be temporary, until the CAMA is in place for audit or direct assignment of tax liabilities.

Recommendations

- Remove from the draft law the clause stating that the reported sale value will be taken as the property value if the property was sold in the past five years. These properties can be assessed through self-valuation.

- Begin implementation of the CAMA as soon as possible.

Acceptability: Benchmarking, Affordability, and Effective Communication

Benchmarking

0.5%-1.0% are typical rates for fixed asset taxes internationally. Property tax rates in the USA and developmental East Asian states are typically about 1% (the exact rate differs by state), while European rates are often closer to 0.7%.

Property Tax in East Africa

Uganda's property tax rate is set by the local authority, but tends to approximate 1%; however, owner-occupied homes are exempt.[19] In Nairobi, face-value taxes are extremely high (e.g. a 34% land tax was proposed in 2015), but these result from grossly under-valued properties (valuation rolls were last updated in 1982).

A article from 2000 compared property tax regimes in East Africa, explaining that regimes vary substantially. Firstly, "There is extreme diversity in *tax base* definitions. Tanzania taxes only buildings. Kenya taxes only land." Uganda taxes buildings and land. The basis for *assessing* property value also differs substantially. "Uganda *uses annual rental value*. Kenya uses capital-based *unimproved site valuation*. Although Tanzania law supports use of market capital value— all building valuation is based on the replacement cost approach." Tax rates also vary in terms of structure (graduation of rates by value, or property type) and the freedom of local authorities to set rates. All countries suffer from out-dated valuation rolls, which undermine real revenues substantially.[20] Below are the article's findings for each country:

- Uganda: The Rating Act (2005) empowers Local Governments to set tax rates from zero to 12 percent of taxable value. The historic legacy is a 6% property tax rate, and no building on the valuation roll may pay less than two thousand shillings (about RWF 500).[21] The tax basis is the market value of buildings and land. Owner-occupied buildings are exempt from property tax.[22]
- Kenya: Kenya's tax rates are set by local authorities, and range from below 10% to over 30%. However, the value of land in Kenya was last assessed in 1982, meaning that values are extremely outdated. The true tax rate is hard to know, until the valuation roll is updated (at which point a new rate will also need to be set).
- Tanzania: Land is not taxed in Tanzania, due to the nationalisation of land under Nyerere. Properties were last valued in 1996, so valuation rolls also under-state the true value of properties considerably, though less than in Kenya.

If Rwanda were to raise its buildings tax rate to match international benchmarks of 0.5-1%, what would result in terms of political acceptability, affordability, and incentives for efficient land use?

Firstly, some are concerned that the jump from 0.1% to 0.5-1% is too great, and will not be acceptable to tax-payers. This statement includes two inaccuracies, however: firstly, for many the starting point (land lease fee) is greater than 0.1%; secondly, the new final effective tax rate is not the same as the 'headline' buildings tax rate, due to the exemption threshold and land tax.

Most people's previous effective tax rate came from the land lease fee, and was typically around 0.3%, though varied considerably. A building tax rate of 0.5-1% would add approximately 0.1-0.3% to their final effective tax rate. Given a rationalised land tax, the final *effective* tax rate for most of those liable would be 0-0.3%, and the top 10-20% would pay 0.3-0.6%.

For previous FAT payers, the increase is from an effective tax rate of 0.1% to new *effective tax rate* of approximately 0.6%. This is a steeper jump, and the author was informed that a similar rate proposed in

[19] It is 6% of annual rental value. If we assume annual rental income is 15% of the full property value (approximately a 15% interest rate on the investment), the implied tax equates to 1% of property value. First homes are excluded from the tax. https://ecitie.kcca.go.ug/portal/revenue-sources-property-rates/
[20] Property Tax in East Africa, Kelley (2000)
[21] http://www.kcca.go.ug/uploads/acts/local%20gorvenment%20rating%20Act%202005.pdf
[22] http://www.ulii.org/ug/legislation/act/2015/2006-7

2011 was defeated in Parliament. However, such a final effective tax rate would bring many richer tax-payers up to rates previously paid by poorer tax-payers, as well as other tax-payers in the region and internationally. It is also important to communicate to wealthier property-owners the *necessity* of property taxes for sustaining government investments in the city; if properly managed, the investments made possible by their taxes will protect, and in fact grow, the value of their assets over time.

In absolute terms, a 1% building tax rate is affordable, especially if the poorest 70% are exempt.[23] A property is typically deemed affordable if it is worth 3.5 times the owner's income. If a fixed asset is worth 3.5 times the owner's income, a 1% tax on the fixed asset value is equivalent to a 3.5% income tax.[24] This is not insubstantial, but compares favourably with the (quite high) rates of other taxes in Rwanda. The tax is harder for the poor to pay, as many inherited or bought land several years ago when it was cheap, and do not now have incomes proportionate to their land values.

One reason the East Asian developmental states were able to raise property and land taxes, politically speaking, was that business and income taxes were, by contrast, relatively low. In Rwanda the top handful of 'large taxpayers' already bear a large proportion of the domestic tax burden, and enforcement and penalties are perceived as quite high. These top tax-payers may resent and resist the removal of this rare 'safe haven' of property tax.

Several consultations were held around the previous draft law, to ensure the support of private and public institutions and to check the wisdom of the proposals against realities on the ground.[25] It would be wise to carry out similar consultations before finalising any adjusted schedule, so people are not shocked if the face-value rate proposed in Parliament is higher than that expected, and to ensure people *understand the real nature of the change*, and are able to give feedback. As above, the necessity of fixed asset taxes for ensuring the sustainability of urban investment must be clearly communicated.

[23] Many of the poorest land-owners do not have incomes proportionate to their land and property values, due to inheriting or buying assets years ago when prices were lower. There is often nowhere affordable for them to move to within Kigali.
[24] If, in Kigali, homes are particularly unaffordable- say, five times average incomes- this rises to 5% of annual income.
[25] Including PSF, RRA, District Finance Directors, District Councils, MINIRENA, RALGA, and others.

Section 2. Land Tax

Description of the Land Tax

The land tax is a local government tax. The proposal in the draft law would charge a set RWF amount per square metre of land held. In urban areas, the range of this tax is RWF 30 RWF to 180 per m^2. The rate for any particular parcel is determined by:

- The 'base' village rate, which is RWF 80-120 in the Central Business District, and 30-80 RWF in other urban areas;
- An additional surcharge (or discount) for holding particularly valuable (or less valuable) land within a village. For example, a flat plot adjacent to a tarmacked road may pay the base rate multiplied by 1.5, while a highly sloped plot zoned for no construction and far from any modern infrastructure may pay the base rate multiplied by 0.5 (these figures are just speculative examples). ***The m^2 tax following these adjustments must still remain within the given brackets***.[26]
- An additional surcharge of 50% of the resultant tax on any land in excess of a 'standard' plot size, which at the upper limit (on a RWF 120/m2 plot) would deliver a final land tax of RWF 180/m2.

The 'base rate' *brackets* are established in the draft Decentralised Taxes Law. A later Ministerial Instruction will detail how base rates are to be assigned to villages and how surcharges are to then be assigned to plots. A Ministerial Instruction from the Ministry of Infrastructure will determine the 'standard' plot sizes, above which the 50% surcharge applies. As establishing a standard plot size is a complicated process, this surcharge can be expected to be introduced no sooner than mid-2017.

Comment on the Land Tax in the Draft Law

The Ministerial Instruction referred to in the new law- to detail how Districts should assign land taxes to plots- can improve substantially on the old land lease fee, by using data to better align land taxes with land values, and to consider appropriate provisions for those who cannot pay. The previous land lease fee suffered from misclassification of some serviced, developed, land as agricultural, leading to disproportionately low rates for some tax-payers. Meanwhile, landowners who divided their plots but kept the usage purely agricultural, or who registered their plots as residential due to having a small informal dwelling on a large agricultural field, were often charged residential rates for their whole plot, amounting to up to 3% of the plot's value; many of these landowners inherited or bought the land years ago when it was cheap, so do not have incomes proportional to their land values, and thus could not pay the fees, while others bought land cheaply in the last decade ago and have seen values rise 5-10-fold or more.[27]

As well as discussions with tax-payers, ***the best data to inform this Instruction would come from the planned Computer Aided Mass Appraisal (CAMA)***. The CAMA will show how land prices vary across locations, and how core features like slope, zone, and infrastructure affect land prices. The CAMA may take a year or more, so would not be ready in time for the first land tax Instruction (though a simpler version can be conducted meanwhile). Following the CAMA, the land tax instructions can be updated, and it will be possible to design a quite effective land tax, where liabilities are well-proportioned to land values, and capture the gains of public investment for sustainable urbanisation. This will rely on appropriately set upper and lower brackets, however.

The new tax will lead to declining land tax rates over time. The previous 'land lease fee' (dating back to 2011) was initially designed to approximate a 1% tax on the value of land, albeit in the presence of very weak data on real land values.[28] The new land tax does not aim to approximate a certain percentage of land value, and in fact does not raise the bracket at all for non-CBD urban areas, despite land values often rising 5- or 10-fold since the initial fees were set. It should thus result in a tax well below 1% of land values.

[26] Source: Conversation with Jackson, MINECOFIN.
[27] Author's discussion with landowners in Batsinda and Kagugu.
[28] [Confirm source: From RNRA document on land valuation for expropriation]

The 'base rate' brackets in the current law are also given in nominal, rather than real, terms, meaning the effective tax rate will continue to decrease sharply over time as land prices rise. For example, if a person's land tax is 0.3% of their fixed asset value in 2016, and prices increase by 30% per year (a modest expectation), the land tax will approximate 0.1% of fixed asset value by 2021.

The top limits of the brackets are also low relative to actual land values for the most valuable plots. For example, the maximum price of land transacted in Kigali in 2015 was about RWF 90,000/m^2;[29] for a 1% land rate, the top RWF tax would thus be RWF 900/m^2. The upper limit in the draft law is RWF 180/m^2 (RWF 120 plus a 50% oversized parcel surcharge), which entails an effective tax rate on that 'most expensive' plot of around 0.2% of land value. In general, landowners with the most prized land, who have benefited and will continue to benefit most from government investments in the city, will continue to pay the lowest land taxes as a proportion of their plot values under current brackets.

The government is wary of setting the upper limit too high, in case districts 'over-charge', applying the high rate to even less valuable plots. This is a valid concern, but one which would be ***overcome as soon as the Ministerial Order instructing districts how to assign land lax amounts to plots is enacted***.

Kenya has also struggled to keep its land-taxes up-to-date. In Nairobi in 2015, a land tax rate of 34% was proposed.[30] This high rate resulted because underlying valuation roll has not been updated in over 30 years, meaning values were grossly under-estimated. The 'real' resultant tax may have been more like 1% of land values. This situation can be avoided by keeping valuation rolls up-to-date, and designing taxes in such a way that they track those values. This is important in Kigali, where land prices are rising rapidly, and many buildings are old, informal, or non-compliant, meaning land represents a greater-than-usual proportion of property values.

It may be wise to also ***remove the bottom threshold on the land tax brackets***. The ability to charge RWF 0-30 per m^2 may be useful, for example, for land on which construction is not allowed (e.g. very sloped/eroded land), land protection for environmental reason (e.g. unfarmed forests), totally un-serviced peripheral land, or land held or occupied by vulnerable groups. Leaving the bottom of the bracket open does not mean plots *must in fact* be assigned those tax liabilities, but leaves the opportunity open should the CAMA show certain plots to be particularly low-value, or should consultations reveal a need to cushion the blow for the lowest-income earners who are unable to pay.

Finally, it will be at least a year before the 50% surcharge for 'oversized' parcels is introduced. Deciding which parcels are 'oversized', for residential flats, single family homes, shops and shopping centres, local and large industries, central and peripheral areas, and so on, will be extremely difficult, and also politically sensitive. The idea of taxing oversized parcels is a good one, to improve the efficiency of land use and help uphold broad-based access to land in the city. However, ***base land tax rates should not be kept low in anticipation of these surcharges***, which may be much delayed, and then fairly lenient. Even a land tax without surcharges can go a long way to encourage effective use of land.

If the land tax is adjusted to better capture the value of high-end plots, a less politically-sensitive instrument to encourage efficient land use would be to ***reduce*** **land taxes on** ***very compact*** **plots**, rather than applying an *extra surcharge* to so-called 'oversized' plots. This also improves policy-maker and tax-payer certainty about the maximum final land tax they may face, as they consider the current law.

Recommendations

- State the land tax brackets in real terms, or 'equivalent 2011 land prices', to account for inflation.
- Lower the bottom threshold for the urban land tax to 0.

[29] RWF 85,000/m2 was the price paid for a plot of undeveloped land in the central CBD on a tarmac road, zoned as industrial. Nearby built plots were sold for closer to RWF 300,000/m2, but their price seems to include the structure value (Source: LAIS data). For purposes of comparison, it's not uncommon to find plots in Cape Town priced at RWF 2 million per square metre, whereas land in central Manhatten is around RWF 8 million per square metre.

[30] http://www.nairobi.go.ke/home/news/valuation-and-rating-bill-2015/

- Raise the upper threshold considerably, to ensure that value created in the highest-value, best-serviced, plots is adequately captured for reinvestment.
- Use the CAMA to inform the land tax assignment to plots, once it is complete.
- Aim for the land tax to approximate a set percentage of plot values, to ensure each plot is taxed proportionately, and to capture publically-created value for reinvestment.

Section 3. Sales Tax

Description of the Sales Tax

The Taxes on Income Law, currently in Parliament, proposes a tax of 5% on the reported sale value of properties, at the point of transaction. Like the buildings tax, this tax is also applied to only the value of the sale exceeding an 'affordable house' threshold to be set by MININFRA, though in this case the tax is applied to the total value of the building *plus land*. This is a Central Government Tax, so does not generate revenues for Districts directly.

Comment on the Sales Tax

Such sales taxes are common across countries, but are most effective where:

- The accuracy of reported sales prices can be monitored and enforced, or incentivised; and
- The tax is not so high as to deter transactions (or the registration of transactions).

In Rwanda, the value of land and properties is not well understood at all, and sector officers responsible for approving sale price declarations have little to no reliable data on the content or characteristics of the plots being transacted to audit people's statements. In addition, few people use their transaction values as collateral for loans, and there is no capital gains tax, which in other countries create incentives for higher/more accurate reports.

This sales tax is approximately twenty-five times higher than the annual buildings tax.

It will be easy and extremely tempting to evade the sales tax by under-reporting transaction values to RNRA. This not only significantly limits the revenue potential of the sales tax: it also undermines the evidence base for the Computer Aided Mass Appraisal. Registered transaction prices are the main data input for this CAMA, which will inform the valuation of all land and properties for tax purposes. Property and land prices in Kigali are rising quickly, making it essential to keep reference prices up-to-date over the next decade if fixed asset taxes are to be effective (**Box 3**).[31]

Box 3. The Importance of Keeping Value Data Up-To-Date: A Case Study from Kenya

In Kenya by 2015, valuation rolls had become extremely out-of-date, so that properties were often 30-40 times as valuable as the rolls suggested. As a result, in order to tax taxed at a 'real' rate of 1-2%, in some jurisdictions nominal tax rates rose to above 30% (e.g. 34% in Nairobi). In Rwanda, if the sales tax initiates widespread and serious underreporting of values (as seems likely), any valuation process will substantially under-estimate true values, meaning a much higher fixed asset tax rate will also be required in order to attain a sensible and sustainable 'real' rate of property tax and level of revenue.

Despite the high tax rate of 5%, the sales tax would likely bring in lower revenues than the land and property taxes, due to the small proportion of properties that are (at least formally) transacted each year,[32] the likely high exemption threshold, an the ease of tax-evasion through mis-reporting.

Transactions are good for the efficiency and productivity of the city, and should not be deterred As well as deterring honest sale value reporting, the tax also deters *transactions*, and the *formal registration of transactions*. Someone who buys a house or plot of land in January, and by December needs to move to a new employment location, liquidate the asset to start a business or pay a

[31] At present, the LAIS contains transaction prices for approximately 4% of plots in Kigali, for a period spanning approximately a year and a half, mostly for more central plots. Within 2 years, the LAIS should contain price data from the sales of at least 12% of plots in Kigali, constituting a much stronger evidence base for mass property valuation.
[32] 3% of plots in Kigali were formally transacted in Kigali in 2015/16 according to LAIS data.

relative's medical bill, or who simply wishes to sell the plot to a more productive enterprise, loses 5% of their investment. China recently reduced its sales tax rate, believing higher rates were responsible for some of the stagnation in the housing market (rates are now 1-2%).[33]

A tax on net value *gain* (sale price minus acquisition or construction price, possibly minus proven improvement expenditure), rather than absolute sale value, would incentivise accurate reporting of prices: higher values reported today reduce the tax due during later transactions, despite increasing them now. It would also exempt owners for whom there is no previous transaction price data for their plot, encouraging accurate 'first' price reports against each plot for the LAIS. This has just been implemented in Kenya, at a rate of 5% of the capital gain.[34]

The sales tax may be a tempting source of quick income, but it risks undermining revenues overall: it acts as a deterrent to transactions, undermines the LAIS, undermines reference prices for the FAT, and applies a very high tax rate (25 times annual building tax rates) to a very narrow tax base (approximately 0.5% of properties annually).[35] Since it is levied on *exactly the same asset* as the new fixed asset tax, yet would bring in lower revenues and undermine those systems, it is advisable to raise the planned revenues through the property and land taxes, and/or to tax only the capital gain.

Recommendations

- Forego or delay the sales tax, and capture the same revenue through the fixed asset tax. This should also make the FAT rise easier to 'sell'.
- Alternatively, levy the sales tax on capital gain rather than absolute sale value.

[33] http://www.chinadaily.com.cn/bizchina/2016-02/19/content_23559984.htm
[34] http://www.revenue.go.ke/notices/pdf2016/Capital%20Gains%20Tax-%20Guidelines%20%20April,2016.pdf
[35] 3-5% of Kigali's plots are formally transacted each year, and of these approximately 20% may in fact exceed the exemption threshold, of which about half may report this honestly.

Conclusion

Review of Recommendations

The Government of Rwanda is committed to reforming its property tax system, to ensure a viable revenue stream for municipalities, and to put urbanisation on a strong and sustainable footing. This paper advised on setting an appropriate buildings tax rate, drawing on recent data from Rwanda as well as lessons from international experience.

More than two years of consultations and analysis have already been conducted regarding this reform, leading to substantial changes; the law has already been taken to cabinet, and the buildings tax rate is the only remaining question. However, an effective buildings tax rate cannot be set in isolation, and must take into account:

- The buildings tax *base*- in Rwanda, the exemption threshold has a large impact on the 'real' buildings tax rate;
- The burden and rates resulting from other taxes applied to fixed assets- the land tax and sales tax; and
- The accuracy of building *valuations*- to avoid a situation like Kenya's, where under-valuations meant rates of above 30% were required to reach 'real' tax rates of around 1%.

We thus considered each of these issues in our analysis.

We modelled how different exemption thresholds affect the final effective tax rate and the proportion of property-owners liable for building taxes. We advised that MINECOFIN should decide what proportion of property-owners it wishes to reach with the buildings tax and set the rate accordingly. We showed that the threshold has a huge impact on final tax rates and revenues, and thus recommended that MINECOFIN or RRA set the threshold directly, rather than delegating this task to MININFRA, and keep the threshold fairly low.

We highlighted ways in which the land tax as designed may be highly regressive, with the lowest effective tax rates paid against the most valuable properties. This makes it difficult to suggest a single buildings tax rate that is appropriate for all. We suggest ways to remedy the regressiveness of the land tax, as well as means to better graduate the burden of the buildings tax according to property value.

The 5% sales tax proposed in the Taxes on Income law would be applied to the same asset as the fixed asset tax, but constitutes a one-off payment equivalent to twenty-five times someone's annual building tax obligation. Taxing the same asset twice is rarely advisable, while this particular tax applies a much higher rate to a much narrower base, increasing the burden for those paying and reducing the stability of government revenues. Furthermore, and most importantly, we highlighted the ***strong incentives created to under-report transaction prices***, and the ***detrimental effect on the valuation rolls for property and land taxes***. We recommended either forgoing this tax, or replacing it with a net value appreciation tax (which doesn't create incentives to under-report). We also strongly recommend that reported sale values not be used as the basis for the *building tax* (as is planned in the current draft law), as this too encourages under-reporting which may undermine the property tax system.

Next Steps

This study was conducted in three weeks. Despite the urgency of passing and implementing the new law, the government should follow its usual practice of taking time to consult carefully with stakeholders (including tax-payers from different income groups, districts, RRA, MININFRA, MINIRENA, and so on) to clearly communicate and receive feedback on any changes proposed to the law that was submitted to cabinet. The IGC is also able to improve the revenue estimates included in this paper by integrating data from the full Kigali LAIS[36]- a process that would take two to three weeks. However, any revenue estimates

[36] In this paper, we rely on a subsample of just 3% of plots- those that were transacted in 2015/16.

should be taken as extremely provisional, until a CAMA has been conducted, the Ministerial Instructions for the new land tax designed, and RRA collection processes have been tested and honed.

Annex 1: Property Tax Regimes Around the World

East Africa

A 2000 article comparing property tax regimes in East Africa explained that regimes vary substantially. Firstly, "There is extreme diversity in *tax base* definitions. Tanzania taxes only buildings. Kenya taxes only land." Uganda taxes buildings and land. The basis for *assessing* property value also differs substantially. "Uganda *uses annual rental value*. Kenya uses capital-based *unimproved site valuation*. Although Tanzania law supports use of market capital value— all building valuation is based on the replacement cost approach." Tax rates also vary in terms of structure (graduation of rates by value, or property type) and the freedom of local authorities to set rates. All countries suffer from out-dated valuation rolls, which undermine real revenues substantially.[37]

Uganda

The Rating Act (2005) empowers Local Governments to set tax rates from zero to 12 percent of taxable value. The historic legacy is a 6% property tax rate, and no building on the valuation roll may pay less than two thousand shillings (about RWF 500).[38] The tax basis is the annual equivalent rental value of buildings and land. Owner-occupied buildings are exempt from property tax.[39]

Kenya

Kenya's tax rates are set by local authorities, and range from below 10% to over 20%. However, the value of land in Kenya was last assessed in 1982, meaning that values are extremely outdated. The true tax rate is hard to know, until the valuation roll is updated (at which point a new rate will also need to be set).

Tanzania

Land is not taxed in Tanzania, due to the nationalisation of land under Nyerere. Properties were last valued in 1996, so valuation rolls also under-state the true value of properties considerably, though less than in Kenya.

[37] Property Tax in East Africa, Kelley (2000)
[38] http://www.kcca.go.ug/uploads/acts/local%20gorvenment%20rating%20Act%202005.pdf
[39] http://www.ulii.org/ug/legislation/act/2015/2006-7

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