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JORDAN FISCAL REFORM PROJECT II JORDAN: THE TAXATION OF REAL PROPERTY

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JORDAN FISCAL REFORM PROJECT II

Jordan: The Taxation of Real Property

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DISCALIMER

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INTRODUCTION

Jordan taxes real property in two ways: with an annual property tax on rental values and with a levy on the value of property transfers. Revenues from the property transfer tax are about five times larger than those from the annual property tax. Both are central government taxes but about two-thirds of revenues from the annual property tax are earmarked for local governments. Together these two taxes account for less than 3 percent of total central and local government revenues.

Jordan has reached a kind of crossroads in the taxation of real property. The annual property tax does not generate significant revenue and is flawed enough in its structure that a comprehensive reform is likely in the near future. The property transfer fee also is under some scrutiny and was subject to a sizeable (temporary) rate reduction in 2009 and 2010. Administration is problematic for both taxes and the institutional arrangements for imposing and administering these levies also raise some important questions. Given that a new property tax law is now in draft form, a computerized mass appraisal system is under consideration, and the current property transfer tax rate is imposed on a temporary basis, it would seem to be a good time to do a critical examination of the whole of the property tax structure.

In this paper, we provide an evaluation of the present Jordanian system against what some would consider to be best international practice, review the proposed reform program and discuss a number of other reform options that might be consistent with government policy.¹ The focus is the annual property tax but we also consider how its performance and its impacts are closely tied to the property transfer tax. This leads us to consider several possible joint reforms. Finally, we offer thoughts about next steps that might be taken in this reform process.

¹ This analysis is based on a two week field visit that included work with a number of central government offices, and with the Municipality of Amman.

I. The Annual Property Tax

The annual property tax in Jordan is a central government tax, i.e., the central government sets the tax rate and defines the tax base, but assigns about two-thirds of the revenue collections to municipal governments on a derivative basis. In this respect, it is more like an intergovernmental transfer than a municipal government tax. However, the municipal governments are assigned responsibility to collect the tax. With respect to the valuation of properties, the central government prepares the assessment instructions, including the per square meter valuation coefficients, and the municipal governments apply these rates to properties within their jurisdiction. It would be fair to say that this administrative discretion in collections and valuation gives the municipal governments some control over the level of revenues raised and over the distribution of tax burdens among those who pay. This is a very different approach to property taxation than is used in most of the world (Bahl, 2010; Bird and Slack, 2004).

Tax Base

The base of the property tax is the annual rental value of all residential, commercial, and industrial properties and of vacant land.² There is no threshold exemption for low valued properties. However, all properties are given a 20 percent reduction in assessed value for depreciation (the words used in the law are “devaluation by lapse of time and use”). For the municipal property tax, special exemptions include the “standard” categories, i.e., churches, schools, charities, government properties, etc. The temptation to give a wide range of exemptions to special interests seems to have been resisted with perhaps the exception of sports clubs and cultural facilities.

Tax Rate

Three separate taxes are imposed on the assessed value of real property. The municipal property tax (10 percent), the sewerage tax (3 percent earmarked for the water authority) and the education tax (2 percent earmarked for the Ministry of Education) are enabled in three separate laws. These three taxes do not share a common exemption list and also have different sets of fines, penalties and early payment discounts. However, these three taxes are collected together and are viewed by taxpayers as constituting a property tax with a rate of 15 percent.

Vacant land is subject to a separate tax regime. It is assessed according to its market (capital) value, and then “decapitalized” at a rate of 2 percent to obtain an estimate of annual rental value. This estimated rental value is then taxed at a nominal rate of 2 percent. In effect, vacant is taxed at 0.04 percent of assessed rental value.

Tax Administration

The identification of properties for inclusion on the tax roll, their valuation, collections, and record keeping are the responsibility of the local governments. There is provision for central government oversight and control in the process, but municipal governments are given a great deal of discretion in property tax administration. The Amman municipality (GAM) appears to exercise more autonomy in property tax administration than do other municipalities in Jordan.³

To identify properties for inclusion in the tax roll, the municipal governments rely on their own field inspections and on transactions and subdivisions reported by the Department of Land Survey. The cadastre for Amman is maintained by the municipal government, and includes information necessary for making an assessment and identifying liability for collection. Other municipalities are assisted by the Ministry of Finance in maintaining the tax roll.

²The present (1954) law does not give a concise definition of “annual rental value” as is found in the law in many countries. It would appear that it is a notional rent that a premise would fetch in an open market.

³ While the finances of all other municipalities in Jordan are regulated by the Ministry of Finance, GAM falls under the jurisdiction of the Prime Minister.

The present law in Jordan makes provision for real property to be valued in two ways. First, if a property is leased or rented, the lease contract is taken as the assessed value of the property. In many cases, this is thought to be a reasonably good estimate of annual rental value at the time the rental agreement is made. In other cases, this evidence can lead to some understatement, because landlords might perceive that they can reduce both their income tax and their property tax liability if they understate the amount of rent received. The local authorities do have the power to make an estimate of the “prevailing” rent when they think a contract rent is too low, but we have no evidence on the frequency or the results of this practice. For rent controlled properties, there is the further issue of “key money”.

The second approach to valuation --- applied in the case of all owner-occupied properties in Jordan – is an area-based method using a reconstruction cost approach to appraisal. The Ministry of Finance develops the valuation coefficients, on a per square meter basis, for various categories of property. These rental values per square meter are combined into a single coefficient and presented in (1998) tables that are attached as assessment instructions to the 1954 law. Assessment teams operating at the municipal level then measure the premise, record its characteristics and apply the per square meter value taken from the table of assessment rates. The goal in this valuation approach seems to be to estimate a depreciated replacement cost for the structure. A 20 percent depreciation allowance is automatically given to all developed properties. In addition, there is a 10 percent deduction for buildings constructed before 1974.

For developed parcels, there is no separation of the tax on buildings from the tax on land, unless the land exceeds a maximum allowable area.⁴ However, within Amman, there are different neighborhood assessment rates that to some extent reflect land value differentials. Moreover, there are four categories of municipality and each is assigned a different assessment rate. So, there is a general feature of the valuation method that attempts to account for land value differentials.

Collections are the responsibility of the municipal governments. The approach taken is much like that in many countries. Taxpayers are sent a notice of taxes due and must come to a local tax office to make payment. There is a well-defined set of early payment discounts, and penalties, as well as a restriction on the sale of property with outstanding property tax liability. The Ministry of Finance assists in collections from delinquents.

Problems and Concerns with the Present System

There are many good features to the property tax practice in Jordan, and a stronger property tax can be built around these features. There are more than 100 valuers working in the local governments and another 100 in DLS, and they are reported to have a long experience in maintaining the assessment roll. The valuation and collection rolls are computerized in the Amman municipal government (GAM). DLS and GAM share information (including land use maps) in an on-line arrangement, and MOF is leading an effort to build a computerized administrative system for the other 93 municipalities. The MOF is on track to complete this work (UNDP project) in the next two years.

But, like the property tax in most emerging economies, there is much room for improvement.⁵ In many respects, the present system of annual property taxation in Jordan could be viewed as being out of step with best practice, and more important, out of step with government policy goals. The following discussion focuses on those problem areas where reform might bring the greatest positive returns, depending on the goals that have been set for the property tax.

Revenue Yield. The central government has not set an explicit target for the amount of revenue it would like to see raised from the property tax. This makes it difficult to argue that revenues raised from the annual property tax are inadequate. What we can say is that by some standards, the annual property tax does not exhibit a strong revenue performance. It accounts for about 2.6 percent of total government taxes in Jordan. As a share of GDP, the level is 0.46 percent, which is equivalent to about three-fourths of the international average for developing countries (Table 1).

⁴ Where land does exceed the maximum allowance, it is subject to an additional vacant land tax.

⁵ For a discussion of the practice in developing countries, see Bahl (2010).

There are several candidate explanations for the low level of property tax revenues in Jordan. Part of the explanation may lie with the legal structure of the property tax, in particular the narrowing of the tax base by granting preferential tax treatments. The biggest of these are the 20 percent deduction for depreciation, and the preferential treatment of vacant land. We can estimate the revenue cost of the depreciation deduction to be about JD 15 million in 2009. The revenue cost of the vacant land deduction is more difficult to estimate, because some of it is un-serviced plots outside the built up area of the municipalities. Still, we can point out that if all vacant land (serviced and un-serviced) were taxed at the full property tax rate, an additional JD 34 million (over 40 percent of 2009 collections) could be raised.⁶

The property tax law does not make explicit provision for other major preferential treatments or special exemptions. The one exception is the case of sports clubs and cultural facilities. Government agencies and some private schools lease these facilities for private use, including for functions such as weddings. The qualified “sports clubs” are certified by the Ministry of Youth. Otherwise, private sports clubs are not exempt from property tax. In the case of charities, the same kind of loophole has appeared. For 93 municipalities (excluding GAM), the revenue loss due to special exemptions is equivalent to about 3 percent of total assessed value. In the case of GAM the cost of special exemptions is equivalent to about 7 percent of the revenue collected in 2009.

Special exemptions and the depreciation deduction together probably cost an amount equivalent to about 25 percent of revenues raised. The revenue cost of vacant lands imposes an additional revenue cost, but we have no way to properly estimate this amount.⁷

Another set of reasons for the relatively low level of property tax revenues are due to administration. In particular, a low collection rate and undervaluation of property might be cited.

Undervaluation plagues the property tax in nearly all low income countries. There are two reasons for the undervaluation in Jordan. First, some undervaluation is to be expected in a system with a five-year revaluation cycle. This is made worse by the fact that a general revaluation is now an additional five years overdue. Second, and independent of the dated assessments, the valuations placed on properties at the time of general revaluation may well have been set well below market levels.⁸

Unfortunately, neither the central nor the local governments make any estimate of the degree of undervaluation in the present tax roll. “Guestimates” by various officials placed the degree of underestimation at 30 to 50 percent. If these impressions of the degree of undervaluation and the collection rate are accurate, it is clear that improved valuation alone might double the level of collections from the property tax. See also Box 1.

Low revenue yield is also the result of a low collection rate.⁹ The Amman municipal government estimates this at about 70 percent against current liabilities.¹⁰ If arrears are taken into account, the collection rate is estimated by GAM officials to be as low as 20 percent.¹¹ We do not have reliable data to estimate the collection rate for the remaining 93 municipalities. Ordinarily, one would assume a higher rate in the larger metropolitan city than in the smaller local governments.

⁶ A better estimate of the revenue cost of the vacant land exemption would be 13 percent of the annual rental value of vacant properties located within the serviced area of the municipalities.

⁷ The preferential treatment of vacant land has three components: underassessment of market value of the property, a favorable de-capitalization rate of 2 percent, and a favorable tax rate of 2 percent. We only have data to estimate the third of these.

⁸ It is well known that reconstruction cost appraisals will not necessarily be equal to market values. Moreover, the construction cost information used in calculating the assessment coefficients may be set too low.

⁹ We define the collection rate as the ratio of property tax collections to property tax liability.

¹⁰ This seems a reasonable estimate. We calculate the collection rate, using GAM-provided data on assessed values and collections, at 67 percent.

¹¹ We have no estimate of the extent to which the delinquent amounts are uncollectable, bad debts.

Box 1

Guessing at the Degree of Undervaluation in the Present System

Many observers agree the assessed property (rental) values in Jordan are well below market (rental) values, but there is no hard evidence to estimate the size of this gap. Various government officials who were interviewed in the course of this work “guessed” that assessed values were between 30 and 50 percent of market rental values.

We might make another type of guess using the *2008 Household Expenditure and Income Survey* in Jordan. From this we can calculate that housing expenditures (less utilities, furnishings, appliances, etc.) are equivalent to about 16 percent of total household expenditures. The ratio of assessed value to GDP in the same year is 6.58 percent of GDP. Though the imputation implied here requires some heroic assumptions, it suggests an assessment ratio on the order of 40 percent.

Collections are always problematic for local governments. Elected local politicians are hesitant to use aggressive collection methods for fear of voter backlash. A 70 percent collection rate does imply a significant revenue loss, but by developing country standards, it is not an inordinately low collection rate (Bird and Slack, 2004). For example, the collection rate for property taxes is reported to be about 50 percent in the Philippines and Montenegro and about 70 percent in Croatia and in much of Latin America (Bahl, 2010).

Revenue Buoyancy. Not only is there a low level of revenues, but there has been little buoyancy in the revenues raised from the annual property tax.¹² As may be seen from the data presented in Table 1, the property tax revenue share of GDP has declined in the most recent few years.¹³ If the demand for municipal government expenditures increases in proportion to GDP, we can say that the property tax in Jordan has not been covering its share of the financing load. If property tax revenues in Jordan had increased in proportion to GDP over the 2006-2009 period, the level would have reached JD 83 million -- about 11 percent more than the actual outcome.

One reason for this slow revenue growth is the absence of a general revaluation for 10 years. Many properties are stuck at 2002 valuation levels, and total assessed rental value is falling farther and farther below market rental value. Another reason for the slow revenue growth is the weakness in the real estate market since 2008. One private sector estimate is that property values have dropped by about 25 percent since 2008, and rents are down 10 to 15 percent with high end rents suffering most. Data provided by GAM and by MOF (for 93 municipalities), however, show that over the 2008-2010 period, total assessed values increased by 10 and 25 percent, respectively (Table 2).¹⁴

¹² The buoyancy of the property tax is the percent change in revenues (including those due to discretionary changes) per one percent change in GDP.

¹³ During the early 2000s, property tax revenues were quite buoyant, especially in Amman, due to a number of factors: rapid economic growth, a population influx, and the shift in administration to local governments (Ministry of Finance, 2007, pp IV-15).

¹⁴ The growth in assessed values in the 93 municipalities seems relatively high. This may be due to municipalities completing their tax roll rather than to natural growth in property values. Moreover, there is always a lag between downturns in property values and reduced property tax assessments.

There also are factors of increase in property tax revenues in Jordan, even between periods of general revaluation. Revenues will grow between revaluation periods because of new properties coming on to tax roll. From Table 3, we can see that the total number of parcels on the tax roll increased by 15 percent over the 2006-2009 period. In Amman alone, the number of parcels (excluding vacant plots) increased by over 100 thousand between 2006 and 2010, and the average assessed value per parcel increased from JD 885 to JD 1047.

Revenues can also grow because of an increased assessment on properties that have been “materially improved”. From Table 2, we can see that between 2006 and 2010, the assessed value per parcel (of developed property) rose from JD 885 to 1047 in Amman and from JD 367 to JD 411 in the other 93 municipalities.

This discussion of revenue growth might be summarized by a revenue – GDP elasticity coefficient of 0.6, i.e., for every one percent increase in GDP between 2006 and 2009, there was an increase of 0.6 percent in property tax revenues. This elasticity is the product of a base effect of 0.4 (which measures how assessed values keep up with GDP), and a rate effect of 1.5 (which accounts of increases in revenue collections for any given amount of assessed values). What we might take away from this is that the revenue growth problem is due to lagging assessed values. See also Table 4.

Fairness. Fairness in property taxation requires that similar properties be subject to the same tax rate and base, and be valued in the same way. The trick here is to define “similar properties” in a way that is consistent with the government’s concept of fairness. By some views, the Jordanian property tax could be viewed as failing the fairness test because there is a difference in the tax treatment of “similar” owner-occupied vs. rented properties. This is because these properties are subject to two different valuation regimes.

For rented properties – including residential and non-residential – the assessed value is taken from rental receipts. Rental contracts must be registered with the local government, and are reported by various government officials to be a good approximation of market rental values. For owner-occupied properties – including residential and non residential – the assessed value is determined from the valuation tables which are meant to approximate a rental value that is consistent with the reconstruction cost of the structure. While there are no independent tests of the uniformity of the assessment ratios, a reasonable argument might be made that owner occupied properties are assessed at a lower rate.¹⁵

There also would appear to be a fairness problem with respect to the updating of assessments during the period between general revaluations. If a property is leased or rented between general revaluations, the new lease amount is taken as the taxable value. If a property is not re-leased between revaluation periods, and if the property is not materially altered, the original lease or rent value remains as the taxed base. In other words, even all renters are not treated the same. It depends on how long they have resided in a premise. The assessed value of an owner-occupied property does not change during the valuation period, unless the property itself is materially altered.

Resource Allocation Issues. The property tax can influence land use choices, and sometimes these choices can have an undesirable effect on society. In other cases, the property tax might be used to try and induce real estate investment behavior that is in the social interest. Whether or not these resource allocation effects make any difference will depend on the responsiveness of investment or consumption decisions to a change in the property tax, and the size of the change in the tax. In Jordan, the most important resource allocation effects would appear to be related to the preferential treatment of vacant land.

Vacant land is taxed at a rate of 2 percent of rental value, whereas developed land is taxed at a rate of 15 percent of rental value. Some would argue that this does not constitute a source of unfairness since many

¹⁵ At least one report has argued that the coefficients used to value owner occupied properties may have been set intentionally below market rental value (Ministry of Finance, 2007).

rural plots are not serviced. However, the preferential treatment holds even if the vacant land is located in the urban area and is fully serviced. The result is that owners of urban vacant land face little by way of tax cost if they hold this land off the market. Meanwhile, the resulting pattern of land use leads to a higher cost of service provision than would be the case under a more compact urban development pattern. This higher cost of service provision must be captured from other taxpayers.¹⁶ This situation has led some countries to impose a higher rate of property tax on vacant or underutilized land than on built-up land. For example, a penalty rate is imposed for keeping “priority lands” out of development in Brazil or for underutilization of land in Venezuela and Senegal.

Some would use the property tax to encourage what are considered to be beneficial choices for society. One of the most common of these social engineering uses of the property tax is the preferential treatment of home ownership. The extent to which home ownership in developing countries is actually encouraged by property tax relief is an open question, as is the question of whether the underlying motivation for the preferential treatment is really to gain favor with voters. While the rationale behind Jordan’s apparent lower taxation on owners is not clear, there is no doubt but that it is a popular policy. We can note that ownership is the dominant form of residential tenure. Of the 656,000 parcels on the property tax roll in GAM (excluding vacant parcels), 71 percent are owner occupied and 29 percent are rented. In the case of the remaining 93 municipalities, the corresponding numbers are 83 percent and 17 percent. Where the practice in Jordan differs from that in other countries is that the preferential treatment of owners extends to non-residential properties.

Social engineering can also take the form of well-intentioned policies to encourage activities that are thought to have merit. The property tax exemption for sports clubs is an example. Few would argue against the national benefits from healthy bodies. But why only government sports clubs and why not any sports club that is open to the public? Moreover, why use property tax exemption as the policy tool, vs. for example, sales tax exemption of athletic equipment or even direct subsidies for sports teams? Finally, there is the question of why not consider the option of removing the exemption for any sports clubs or cultural facilities that are income generating.

Another possibility is that the social engineering justification is a guise to lower tax burdens, either to gain political favor or to redress a perceived regressive element on the property tax. The 20 percent depreciation deduction is a case in point. This is an entitlement for all property taxpayers, and the same percent deduction applies if a property is five months old or five years old or ten years old. Only when construction is pre-1974 does the percentage rise. In effect, the depreciation deduction is less an allowance to correct valuation for age than it is a standard deduction from property tax liability.

Administrative procedures and Information

The basic requirements for a well administered property tax are not yet in place in Jordan. Some of the shortcomings have to do with procedures, some to information problems and some to a lack of monitoring. These problems show up in all three key areas of administration: maintenance of the tax roll, valuation and collections.

Maintenance of the tax roll requires up to date information on changes in ownership and in the physical description of structures. The goal of local governments should be to have this key information for every property within its jurisdiction. This information base should include the unique parcel identification number, physical description of the property, land use and ownership.

Under present practice, much of the data must be assembled by the municipal government property tax department. DLS passes information about changes in ownership to GAM and to MOF in an on-line form,

¹⁶ This higher cost of service provision occurs because public facilities must be built to accommodate these vacant plots, e.g., utility lines, bus routes, etc. Arguably, if these plots were developed and fully taxed, the per parcel property tax costs assigned to taxpayers would be lower.

but does not maintain information on the physical description of structures in its computerized data base. This poses a major problem for a valuation system that uses a reconstruction cost approach. Moreover, the DLS data base only includes properties that have been transferred, therefore it is not comprehensive.

These information problems mean that the property tax cadastre is incomplete, though data are not available to measure this in any precise way. However, this does not mean that the tax base is stagnant. In fact, we can say that between 2006 and 2010, there was an increase of 271 thousand parcels (20 percent) and 41 percent of this increase was vacant properties.

A second general problem is with valuation, the goal of the government is to begin each revaluation period with an assessment on each property that approximates market rental value. Every five years, a general revaluation will restore each assessment to its market level. Between general revaluations, provision is made in the law to reassess any property when there is a “material change” such as a physical improvement or a change in land use.

Unfortunately, this system does not fully work. First, it is not clear that the basic approach to assessment yields an estimate of market rental values. At least some observers might argue that the area-based approach used for owner-occupied property produces a low estimate relative to market rental value. Second, the general revaluation is now ten years out of date.

Finally, the valuation teams that are continuously reviewing properties may not have the staff resources to do the necessary field work.¹⁷

The law makes provision for three person assessment teams to carry out a continuous updating of the tax roll. Government officials refer to these as “trained valuers” as evidenced by their number of years of experience at doing this job. It is not clear however that there is a specified course of training or a formal certification for each valuer. Moreover, the work of these teams is less valuation than it is measurement, observation of material changes in the structure or land use, and application of the valuation coefficients. While the Law is not explicit about technical qualifications, it does require that each assessment team be composed of a government employee, a member of the local council and a taxpayer in the district. Unfortunately, the government does not do a sales ratio study, so there is no objective evidence on the degree of underassessment in the tax roll.¹⁸

Finally, there is the problem that the collection rate against current liabilities reduces revenues. For GAM, the collection rate is estimated to be about 70 percent. (Incomplete) data provided by MOF suggest that the collection rate is no lower for the remaining 93 municipalities. Shortfalls in collections might be due to several factors. One is that penalties either are not severe enough, or there is little fear that they will be enforced. Under the present law, there is provision for penalties of 10 percent per year on the unpaid tax amount. This may accumulate to a maximum of 50 percent. Even with this penalty rate, however, the delinquency amounts have increased.

GAM has tried several other approaches to increase compliance and to collect tax and penalty from delinquents:

- a) They used the newspaper to inform citizens of their obligations to pay.
- b) Between 2004 and 2007, they targeted specific delinquents for special attention.
- c) After 2007, they turned the delinquent list over to the MOF for more stringent enforcement actions such as publishing the names of delinquents in the gazette, and threatening taxpayers

¹⁷ The 1954 property tax law gives the assessment committee the right to review the assessment every year.

¹⁸ In the case of Jordan’s present system of property taxation, a sales-ratio study would compare assessed rental value with market-rental value. It is not exactly clear how this could be done, particularly for owner occupied properties.

by issuing a letter of seizure.¹⁹ It is not clear how much success there has been with these MOF actions.

The collection rate may have been compromised by the three amnesties called during the 2000s. Under these amnesties, taxpayers could remit delinquent amounts without penalty. It often is argued that amnesties can have the perverse effect of causing taxpayers to postpone payment in expectation of yet another amnesty. It also sends an unhealthy message to taxpayers who voluntarily comply: that evaders will not be penalized.

¹⁹ "Seizure" in Jordan does not mean that the property is taken and sold at auction. This is not done. The sanctions are that bank accounts (and maybe salaries) are embargoed, and that a travel ban is placed on the person. There is also an inability to transfer the property since a tax clearance certificate cannot be obtained by the owner.

II. The New Annual Property Tax law

The Jordanian property tax presently operates under the (amended) law of 1954. A new property tax law is under preparation,²⁰ but it is still undergoing significant revisions. Some important issues, such as the tax rate and the possibility of graded assessment ratios have not yet been fully addressed.²¹ So, it is too early to make an estimate of the potential revenue consequences of the new law. Moreover, the new draft law has not yet been subjected to Parliamentary review. In its present form, the draft law would retain some structural features from the 1954 law, but there also are some quite significant changes proposed for the structure of the tax.

Proposed Major Changes

The major proposed change in the law is the adoption of a new property tax base -- the capital value of land and improvements. Though the draft law does not yet specify the definition of full market (capital) value (e.g., the amount the property would fetch in an arms length sale), it seems clear that the intention is to abandon the present rental value base. The change seems well advised for two reasons. First, the property transfer tax is levied on a capital value basis and data from sales are potentially important information for annual property tax assessments. Second, tenure in Jordan is dominated by ownership. Owned properties account for 71 percent of taxable properties and 56 percent of assessed value in GAM, and 82 and 57 percent, respectively in the remaining 93 municipalities.²²

Another important change proposed in the new law is a legislated uniformity in assessment. Whereas the present law calls for using a reconstruction cost approach for owner-occupied properties, and rent contracts for rented properties, the new law calls for using the same set of assessment tables for all properties. It is proposed that evidence on rents actually paid no longer be used in valuing properties.

The new law also would simplify the system by the elimination of separate legislation for the imposition of municipal, sewerage and education taxes against the property tax base. All three will be brought together under the proposed new (uniform) property tax law. The total revenues collected from the property tax will be divided 60/40 between the municipality and the other two recipients, which is about the same proportion as under the old regime.

Proposed Status Quo

Some provisions in the 1954 law are proposed to be retained in the new legislation. Five areas that is particularly important.

1. The preferential treatment of vacant land is not changed.
2. The new draft law will retain all exemptions involving not for profit activities, as in the present law. No new exemptions are added in the draft.
3. The provision for a general revaluation at least once every five years remains in the new law.
4. The division of responsibilities for valuation and the reconstruction cost approach to valuation are not changed.
5. The 20 percent depreciation allowance is not changed.

Major Issues

The major issue to be dealt with is the level of the tax rate. The present discussion is to reduce the 15 percent rate (on rental value) to 10 percent. Presumably this will be converted to a rate that will be

²⁰ At the time of this writing.

²¹ A "graded assessment ratio" is the case where different classes of property are assessed at different rates of full value. For example, residential property might be assessed at 50 percent of full market value, whereas commercial property might be assessed at 75 percent of full market value.

²² These calculations are for 2010 and exclude vacant parcels.

commensurate with the new capital value base. The safeguards against revenue loss will be a general revaluation and possibly a higher assessment on commercial property.

III. The Present system: The Property Transfer Levy²³

Jordan levies a tax on real property transfers at a rate of 5 percent. Previously the overall rate was as high as 10 percent but was reduced over the past two years to its present level in June, 2010.²⁴ The rationale for the rate reduction, presumably, was to buttress a sluggish real estate market. It is too soon to estimate the impact of the rate change on total property transfers.

The base of the transfer tax is the amount for which a property would transfer in an open market. Inheritances and intra family transfers are subject to special tax rules.

The Director General of DLS has the authority to make the final decision on the taxable value of the sale, though his opinion may be appealed. This is much the way that property transfer taxes operate in most countries.

In practice, the responsibility for determining the tax base (sales value) rests with the valuation section of the Department of Land Survey (DLS). DLS may either accept the declaration of value by the seller, or they may make an independent estimate of value. It is reported by DLS that the declared value is accepted in less than 10 percent of the cases.

Most of the estimated values are done on a basis of desk review rather than field visits. The valuation is done by using a combination of an index of land values that DLS keeps up to date, and a construction cost-based estimate of the value on structures. The latter is determined from a DLS value table that is calibrated in terms of size, quality, and land use. One might expect field visits to all properties where declared values are suspiciously low. This is not feasible, however. Note that of a total of 1.6 million parcels subject to the annual property tax in 2009, 271 thousand or 16 percent were exchanged in that year. The DLS staff includes a total of 100 valuers. Given that DLS appraisers have other responsibilities (e.g., appeals), it is only reasonable to expect that the valuation done for the property transfer tax is more desk analysis than site visits.

The revenue performance of the property transfer tax is described in Table 5. Revenues have declined over the 2006-2009 period both in nominal terms and as a percent of GDP. This is in part due to the weak real estate market after 2008, and to rate reductions, but revenues have been growing more slowly than GDP since the mid 2000s. Even so, the property transfer tax remains a more important revenue source than the annual property tax.

What is the revenue potential of the property transfer tax? Even if we account for the recent weak performance of the real estate market, there remains the issue of whether transfers are accurately valued. In fact, there is no independent assessment of the accuracy of the market values as assessed by DLS. Officers interviewed in DLS speculated that 70 percent might be a reasonable estimate. On the other hand, they argued that in many cases, their estimate could exceed market value. The possibility that the DLS estimate could be over or under full market value was confirmed in a later meeting with a private real estate company.

The proposed new annual property tax law has an important implication for the property transfer tax. Conceptually, the two tax bases used in the assessment of tax liability will now be the same, therefore both

²³The property transfer tax was enabled by law in April 1974 as the *Property Sale Tax Law no. 21 for the Year 1974 and its Amendments*. The original rate was 4 percent.

²⁴ Actually, the transfer tax or fee is a series of taxes on buyers and sellers, some of which is earmarked for special purposes. What we refer to here is the aggregate rate, which is 5 percent at the time of this writing.

could be supported by the same data base on parcels, land use and physical characteristics of properties. Completely separate assessment operations and independent recordkeeping will now involve a costly duplication of activity.

IV. Institutional Arrangements

The present system of property tax administration in Jordan is an interagency matter. It involves (a) oversight by the Ministry of Finance, (b) a division of responsibility for valuation between the Ministry of finance and the municipal governments, and (c) a sharing of information that involves the Ministry of Finance, DLS, the municipal governments and the Ministry of Municipal Affairs. Since these institutional arrangements are not likely to change very much under the new law, it is important that they be factored into the design of the new system. There would appear to be some opportunities for better integration. The following is a brief review of the institutional arrangements that are presently in place.

Control over the Local Government Property Tax

The Ministry of Finance is the oversight body for local government property taxation. The MOF is leading the preparation of the new law on property taxation, though there is a relatively broad participation in this effort. In the end, it will be the MOF that submits the final draft of the new law to parliamentary review.

Another important responsibility of the Ministry of Finance is to establish the rate at which real property will be assessed. It prepares the valuation (coefficients) for all 99 municipalities, and issues guidelines for the application of these coefficients.²⁵ With respect to control over the more day-to-day administrative activities, the MOF is responsible for 93 of the 99 municipalities in Jordan. The Greater Amman municipalities come under the jurisdiction of the Office of the Prime Minister. In approximately two years, the MOF will hand over its oversight duties for the 93 municipalities to the Ministry of Municipal Affairs.

Greater Amman Municipality (GAM)

The Greater Amman Municipality values and collects property taxes within its boundaries and on behalf of five smaller municipalities. It maintains its own cadastre. Amman (GAM) accounts for about 70 percent of all annual property tax collections in the country.

The Department of Land Survey (DLS) is a basic source of data for the GAM tax roll. DLS supplies information on three factors: ownership, area of the property, and date of ownership transfer. Most of this information is on line, and the information sharing does not appear to be a contentious issue.

There are, however, some problems with the exchange of information. Some of this might be easily corrected under the new property tax law, or by the allocation of more resources to property tax administration. GAM reports that DLS is behind on data entry, and moreover, does not supply adequate data on structures. "Adequate" means that the DLS data do not include the specifics on buildings that will enable an assessment based on the valuation tables. As a result, GAM officers must go physically to DLS to gather the necessary data from the (paper) files. Alternatively, they must visit the property.

Under the present system, the important information that DLS supplies to GAM is about ownership and property characteristics rather than about transfer values. Under the new law, DLS estimates of transfer values of property will be more important (though it is not clear how this information will be used in the valuation process). Moreover, under the new law, GAM may be in a position to supply DLS with either the data necessary to carry out an assessment, or directly provide an assessment of market capital value.

²⁵ It is not clear if the MOMA will assume this responsibility in two years, when it assumes responsibility for more fiscal oversight for the 93 municipalities (excluding GAM).

Other Municipalities

The 93 municipalities (excluding GAM) are of varying sizes, as is shown in Table 6. Of these, 52 now implement the MOF valuation tables, maintain their own cadastre, and collect property taxes. The 52 municipalities receive information on property transfers within their jurisdiction from the MOF, who receives this information directly from DLS. At present, the records are kept in manual form. However, the expectation is that within two years, the OECD project to computerize the data will be complete. At that time, the remaining 41 municipalities should begin collecting the tax. Oversight responsibility will then shift to the Ministry of Municipal affairs. Greater Amman will continue as a separate administrative system.

Department of Land Survey (DLS)

The Department of Land Survey is responsible for registering all property transfers. The process involves four steps.

- a) The seller must fill out a form, and this includes a declaration of the transfer price. This can be done at any DLS office, and there are 33 in Jordan. A notary cannot be used, but power of attorney can be given to a qualified representative.
- b) Certification that all taxes have been paid must be obtained from the relevant tax offices. This is the sellers' responsibility. Property tax clearance certificates must be obtained from the appropriate municipal government.
- c) The property must be valued by DLS, or the declared value may be accepted.
- d) A contract is prepared, and both parties (buyer and seller) must appear to sign the transfer and pay the taxes (or must be represented).

At the time a property transaction is registered, the property transfer tax is collected. The collections are then remitted to the central Treasury.

The DLS plays an important role in providing data to support the annual property tax. DLS maintains a computerized data base for properties. The files include a unique parcel ID, all titles and parcel maps. Transactions are recorded for each parcel. There are no data on buildings in the computerized records. The records on property transfers are shared on an appropriate basis with both MOF and GAM.²⁶ Apparently, online parcel maps are shared with GAM.

V. Reform Choices

The new annual property tax law is presently in a draft form and is under review by the relevant agencies. Several important changes are proposed and the government seems to have decided to move ahead with these. In general, these will strengthen the property tax. However, a number of important issues have not yet been settled. Therefore, it seems a good time to evaluate some other reform choices that might not yet have made it to the discussion and that might be worthwhile to consider. Moreover, there is the question of strengthening the administration of the tax, which is necessary to make these reforms effective.

In the discussion below, the reform choices are grouped around nine themes:

- Revenue Mobilization
- Annual Revaluation
- Sales Ratio Analysis

²⁶ DLS explained that there are some confidentiality restrictions on sharing this information. The most relevant is that the information may be shared automatically with any jurisdiction where the property is located, but not with other jurisdictions.

- Unified Cadastre and Data Base
- Separation of appraisals from Tax Rate Decisions
- Reduced Property Transfer Tax Rate
- Adopt a Capital Gains Tax on Real Estate
- Integrate the Property Tax and the Property Transfer Tax
- Fiscal Decentralization

Some of these could be freestanding reform options while others would necessarily be part of a reform package. We claim no expertise on the political feasibility of any of these options.

Revenue Levels

A major decision that the central government must make is about the level of revenue it intends to raise from the annual property tax, i.e., whether the intention is to increase revenues above the present level. The government would benefit from setting a revenue target for the annual property tax. This would enable fiscal planners to make a better informed decision about the level of the tax rate, the structure of graded assessments and exemptions and deductions. It also could lead to some guidelines about necessary collection rates and valuation levels.

Certainly there is a good case to be made for significantly ratcheting up the level of revenues from the annual property tax. Three justifications might be introduced. The first is that municipal governments in Jordan are in a deficit position, and these deficits are being financed primarily by central grants. Data taken from the Annual Report of the Ministry of Finance show that in 2008, expenditures of municipal governments exceeded revenues (including recurrent intergovernmental transfers) by JD 31 million or by 6 percent of total budgeted revenues. This deficit is covered by additional central government grants and by borrowing from state banks. GAM approved a budget deficit for 2010 that is equivalent to about 12 percent of total spending.²⁷ Such municipal deficits make a compelling case for increased local government property tax revenues.

A second justification is the demand for increased municipal government expenditures. The leadership in Amman appears ready to support a property tax increase. The City Manager in GAM argued in an interview that a doubling of property tax revenues in Amman was needed.

Finally, by international standards, there would appear to be some space for a property tax increase. If revenues were increased by 30 percent, the property tax in Jordan would reach the international average in developing countries.

How could the government generate a 30 percent (or greater) increase in property tax revenues? Are there feasible options? The answer is that there are several instruments that might be used to reach this target or even a higher level. The main point to make here is that the design of a revenue enhancement package should be comprehensive rather than focused on one dimension, and should involve both the central and the local governments.

To demonstrate this point, to help identify the elements of a revenue enhancement strategy, and to give some idea of revenue possibilities, we make use of a simple simulation exercise. The following identity outlines the components of property tax collections:

$$T_C = \left(\frac{T_C}{T_L}\right) \left(\frac{T_L}{AV}\right) \left(\frac{AV}{TMV}\right) \left(\frac{TMV}{MV}\right) \left(\frac{MV}{GDP}\right) \text{GDP} \quad (1)$$

²⁷ "City Council Approves the Budget of 2010." <http://www.ameinfo.com/218453.html>

Where

TC = property tax collections

TL = property tax liability

AV = assessed value

TMV = taxable market value

MV = full market value

GDP = gross domestic product

This identity underlines the point that many factors drive the level of property tax revenues, and that all must be accounted for if a reform is to lead to a significant revenue increase. For example, an increase in assessments may not increase property tax revenues if the collection rate declines, or an increase in exemptions may partially offset the revenue enhancement from an increase in the legal tax rate. Adding to the complication in Jordan is that some of these components are under the control of the local government, some are under the control of the central government, and some are determined by market forces. Revenue management of the property tax in Jordan is no easy matter.

The first term on the right hand side of equation (1) is the collection rate, which is a factor that is controllable by the municipal government. Amman estimates that the collection rate is about 70 percent against current liabilities. The Ministry of Finance sets the penalty rates, and may aid in enforcement, or even may grant amnesties. But on day-to-day matters, the responsibility for enforcement in the Jordan regime is mostly with the municipal governments.

The second term is the legal tax rate, which is set centrally. At present and even in the draft law, the tax rate is stated as 10 percent of rental value for municipalities and 5 percent for the water authority and the Ministry of Education.²⁸ However, because the tax base is proposed to change to full market (capital) value, a much lower statutory nominal rate will be called for. Once the government calculates a revenue neutral rate against the new capital value base, it can decide on whether the new effective rate will be higher or lower. The higher this new rate is set, the greater will be the revenue potential of the property tax under the new regime. However, the choice of the rate will need to be taken in conjunction with possible compliance reactions.

The third term is the assessment ratio, i.e., defined here as the percent of taxable (market) rental value that is assessed for purposes of property taxation. The goal is for the assessors to capture the full market rental value of the properties in their appraisal. Since there is no sales-assessment ratio study done, there is no estimate of the present degree of underassessment. However, from the division of responsibility for property tax administration, we know that both the central government, who supplies the assessment tables, and the local governments, who apply these factors to individual properties, can affect the assessment ratio.

The fourth term is the percent of full market value that is legally taxable. The size of this ratio depends on the level of legal exemptions, and on the general discount given for depreciation. The MOF estimates that the cost of exemptions was equivalent to only about 3 percent of assessed value for the 93 smaller municipalities in 2009. The estimates by GAM are for losses equivalent to about 7 percent. The depreciation discount (excluded from the above estimates of revenue loss) is a flat 20 percent of assessed value. Exemptions are given only by the central government.

²⁸ The proposed rate in the new law has not yet been decided (at the time of this writing). However, discussions with MOF officials suggested that the new rate might be lowered. A rate equivalent to 10 percent (vs. 15 percent) under the existing regime was discussed. This suggests that government is not thinking about using the tax rate as the major factor in increasing revenues.

The final component is the market value of property relative to the level of GDP, which is mostly determined by market factors.²⁹ Presumably, the automatic increase in property tax collections is driven by increases in GDP.

We can use this identity to demonstrate the considerable revenue potential of the property tax in Jordan.³⁰ These calculations are based on 2009 data for the present rental value system. In row (1) of Table 7, we identify the components of the actual level of property tax collections relative to GDP (0.46 percent) based on estimated values, some assumptions, and a calculated value of the ratio of market rents to GDP. These baseline values might be summarized as follows:

1. The collection rate is 70 percent for GAM as estimated by government officials. We have no good estimate of the collection rate for the remaining 93 municipalities, so will assume that this rate is also 70 percent.
2. The legal tax rate is 15 percent and includes the municipal rate, the sewerage rate, and the education rate.
3. The assessment ratio is assumed to be 50 percent. Based on interviews with various government officials, some rough calculations and a priori reasoning, one could argue that 50 percent is not a low estimate of the assessment ratio.
4. The exemption rate (including the depreciation discount) is assumed to be 25 percent, based on government estimates for special exemptions and 20 percent of revenues for depreciation. This means that the maximum value of taxable to total market value is 75 percent.
5. The calculated ratio of market rents to GDP is about 12 percent. This value is calculated to satisfy the identity described above. From the household expenditure survey, we can calculate housing expenditures less utilities and maintenance to be about 16 percent of total household expenditures. So, an estimated rental value of 12 percent of GDP does not seem unreasonable.

Against this baseline, we consider six revenue enhancement scenarios:

1. The collection rate is increased from 70 to 80 percent, and all else is held constant.
2. The assessment ratio is increased from 50 to 75 percent, and all else is held constant.
3. The nominal tax rate is increased from 15 percent to 20 percent, and all else is held constant.
4. The exemption rate is reduced from 25 percent to 5 percent by eliminating the standard depreciation deduction, and all else is held constant.
5. All of the above reforms are enacted simultaneously
6. All the reforms are enacted simultaneously, except that the nominal rate is dropped from 15 percent to 10 percent. This is a measure that is being discussed for inclusion in the new law, and could be a way to soften the shock of a comprehensive reform.

In column (1), we show the revenue results of these simulations, expressed as a percent of GDP. All calculations are based on 2009 revenue levels. An increase in the collection rate alone (Scenario 1) will drive up revenues to 0.53 percent of GDP (column 1) or by a factor of 1.15 (column 7). This illustration suggests that an increase in the collection rate to a level of 90 percent would give a 15 percent revenue increase but still would leave the property tax below the international average level. A much better revenue

²⁹ One could argue that government policy can effect property values. For example, property transfer taxes could be capitalized into lower property values, and mortgage subsidies could affect market values.

³⁰ Ideally, a separate analysis will be done for vacant properties since these are taxed under a separate regime.

result would come from any of the other enhancement measures considered here, i.e., an increase in the tax rate or assessment ratio or elimination of the depreciation allowance.

If all of these discretionary changes were enacted simultaneously, property taxes could nearly triple (scenario 5). It would appear well within Jordan's reach to push property tax revenue collections above the international average for developing countries.

Annual Revaluation

The draft law calls for a general revaluation at least every fifth year as did the 1954 law. This 5 year cycle causes revenues to lag changes in the market value of property and introduces a valuation shock when the new tax roll is approved in the general revaluation year. If the revaluation is delayed, the revenue loss is greater and the shock is more problematic. Because they are fearful of the political fallout that might come with the shock effect, elected officials will often roll back the tax rate when they introduce the new tax roll. Jordan is no stranger to this situation. The present tax roll is now in its tenth year, and the previous tax roll was used for 18 years.

The reform that would best address this issue is a general revaluation every year. Usually, this is impossible for a developing country because of the shortage of skilled valuation staff and the absence of necessary data to establish taxable values on every property. However, this might be a feasible approach in Jordan. First, valuation is done by reference to a table of coefficients that show values per square meter for various types of properties. The main job to be done by MOF in implementing an annual revaluation would be to update this table of coefficients annually. The additional work and cost implied should be easily justified by the increased revenues. The main job to be done by the municipal governments would be to apply the new coefficients to the updated (measured) cadastre. At least in GAM, with 35 valuation teams working year round to update the cadastre annually, this should be feasible. Even if the changes in property characteristics are taken into account every year, as is suggested here, provision still could be made for a general review every fifth year. In effect, the tax roll would be indexed annually with the new valuation coefficients, augmented by annual upgrades to properties as identified by the assessment teams.

A less satisfactory approach to indexing the property tax base is to increase valuation annually by the (lagged) value of some appropriate index. The drawback of this approach is the implied assumption that all property values grow at the same rate. Indexation may or may not soften the problem of revaluation shock, but clearly it would provide a less erratic revenue flow.

Sales Ratio Analysis

Neither the central nor the local governments have any hard evidence on the extent to which they are under assessing property. Nor do they have evidence on the variation among properties in these assessment ratios. This raises a number of problems for implementing an effective property tax:

1. The revenue impacts of revaluation cannot be properly estimated. The importance of this is illustrated by the present reform where the new legal tax rate will be set based on an estimate of how much base-broadening will result from the general revaluation.
2. The accuracy of the assessment methods cannot be fully evaluated. The construction cost method now used should be at least benchmarked against the amount of market value that it reflects. If it is sufficiently different, adjustments in the methods for calculating the assessment coefficients might be called for.
3. Because there is no information about the ratio of assessed to market value, local governments cannot evaluate assessment inequities among taxpayers.
4. In allocating transfers among local governments, the central government may want to take account of property tax effort. But without a sales ratio study, it would not be possible to differentiate between low tax effort and low tax capacity.

The new law does provide for an inspection function in valuation. As it is presently structured, the vision seems to be that the inspection function will be a kind of internal performance audit for the property tax. Another form that this inspection might take is for a sales ratio study to be done by an “external” body (e.g., the central government). This could be carried out annually as a check on the accuracy of the assessments. Whether the Ministry of Finance would be arms-length enough to oversee this sales ratio study is an open question.

Doing a sales ratio study would not be easy, and likely would be costly. It would need to be overseen by government but it almost certainly would need to rely on private sector appraisals since there is little no objective data available on the market value of properties.

Unified Data Base and Cadastre

The property tax is a central government tax in Jordan. This coupled with the fact that Jordan is a relatively small country whose economy is dominated by Greater Amman suggests that a unified (national) cadastre/property data base is feasible.

The advantages of a central information system would be considerable. The data bases of DLS (property transfers, cadastral maps, and transfer values) and those of municipalities (identification of all properties and structures) could be combined and made available to those responsible for imposing the property tax and the property transfer tax. Both systems would be improved by such a merger. The municipal governments would have updated information on transaction values while the DLS would have access to more complete information. The centralized system could be developed and managed by the Ministry of Finance.

Since the new law will bring all assessment to a common, capital value basis, there could be some economies in the valuation process. Both DLS and the municipalities now will be charged with estimating the market value of properties and there could be economies in combining this effort. If government decided to continue with a depreciated construction cost method, both DLS and the municipalities could use the same valuation tables. A unified data system would enhance the ease with which this could be done.³¹

The development of a unified data base and cadastre also could be useful in monitoring the work of the municipal governments in completing their cadastres. In order to complete the data base, each municipal government would need to enter its roll of properties and its description of structures on each property. This would provide at least some information that the MOF (or MOMA) could use to determine whether the municipal governments were making an adequate effort to complete their property tax rolls.

Separation of Appraisals from tax rates

The appraisal job is a technical one. The goal is to estimate an accurate value for every property, without any concern for the tax burden implied. This objective holds for those constructing the assessment rate tables and it certainly holds for those who apply these coefficients to individual properties. From a point of view of good valuation, there is no room for assessing “like” properties differently based on residential vs. commercial use, or rented vs. owner-occupied status. Nor is there room to alter assessments in order to alleviate the tax burden on particular classes of taxpayers.

The setting of tax rates, on the other hand, is a political decision. These decisions determine how much revenue will be raised from a property value base and how much of the tax burden will fall on various types of properties. Political leaders will do what they do based on national and local objectives, but this

³¹ Of course there would be problems with working this out. The annual property tax is now assessed at the time of revaluation and the assessment is changed only when a material change is made to the (owner-occupied) property. The property transfer tax is levied on the value at the time of sale. There are several approaches to resolving this issue, as is suggested in the discussion of revaluation below.

needs to be kept separate from the more technical job of valuing properties. Whatever tax rates are chosen should be applied to a best estimate of true market value and in that sense all properties will be treated fairly.

Political considerations may lead to various kinds of recommendations on the rate structure of the property tax, and this may lead to higher effective tax rates on certain types of properties. The following are some illustrations:

- A graded property tax may be adopted, under which commercial properties are assessed at a higher percent of full value, while residential properties are assessed at a lower percent of full value. This might be done to alleviate the tax burden on residential properties.
- Rates might be set higher in GAM than in other municipalities so as to recoup the higher marginal costs of providing services there.
- The tax rate on vacant property apparently is now set at a different level than that on other property so as to protect those who are “property rich but income poor”.
- The tax rates against capital value in the new law may be chosen based on the revenue objectives of the government. When this is done, the preferential treatment now proposed to be received by vacant properties is magnified.

Keeping the appraisal and the political rate setting separate can make the property tax process more transparent and can help avoid some unintended misallocation of resources from the political decisions. Political objectives may change, and this should be reflected in rate changes and exemptions. The valuation roll should be protected from this and be focused exclusively on assigning values according to what the law prescribes. If, for example, government wants to shift more of the tax burden on to commercial users, this should be done by raising the tax rate on commercial properties and not by revising the coefficient for commercial properties in the assessment table. Graded assessment ratios are discussed in Box 2.

To honor this principle of keeping the political decisions separate from the technical appraisal process, and making the property tax more transparent, the following might be considered for inclusion in the new law:

- The tax base for vacant property should be the full market (capital) value, determined in the same way as for other properties. Any differential tax treatment of such properties should be explicitly stated in the tax rate.
- Land use should not play a role in the construction of the assessment coefficients. Let commercial and residential land be valued by the same principles, irrespective of use. If there is to be a differential treatment, let it be given in a different nominal rate charged to non-residential property.
- The law makes provision for three member assessment committees that update the physical characteristics of properties, and calculate assessed value. By law, the committee must include a member of the local government council and a taxpayer in the district. This all but guarantees that valuation outcomes will be affected by “other” considerations. The government might consider dropping the requirement of political or at large members of each assessment team, in favor of a requirement of professional expertise.

Box 2

How a Graded Property Tax Might Work

Suppose properties are classified into three groupings: residential and industrial (R), commercial (C) and vacant (E), with true market value assessments of VR, VC, and VE, respectively. Under a flat rate, uniform tax, and with full compliance, property tax revenues (PT) are:

$$PT = r (VR+VC+VE)$$

Where r is the legal tax rate.

Under a graded system

$$PTR = r \alpha_1 VR$$

$$PTC = r \alpha_2 VC$$

$$PTE = r \alpha_3 VE$$

Where the α_i are assessment ratios set by the government. In effect ($r \alpha_i$) are the tax rates so the same result could be accomplished by setting three different tax rates in the law. In any scenario, however, the valuations remain the same.

Lower the Transfer Tax Rate

There are major disadvantages to a property transfer tax. First, it raises the cost of property transactions and slows the development of the real estate market. Properties may be held in suboptimal uses because the tax is large enough to discourage a transfer, and this imposes an efficiency cost. Second, buyers and sellers may find other (non arms-length) ways to make the transfer so as to avoid the tax. Third, if the tax is properly assessed, administrative costs could be very high, because of the need to verify the declared sales prices and revalue when necessary. In many countries, declared values are not checked for accuracy. A study of over 26,000 property transactions between 2001 and 2003 in Jamaica (where the transfer tax rate was 13 percent) shows that only about 7 percent of the declared values were audited (Bahl 2004). There is a long list of countries with a similar experience. Finally, a property transfer tax gives property owners an incentive to understate taxable value, and so it weakens the database that is necessary for objective assessment of the urban property tax.

A moment's reflection will lead one to the conclusion that the problems with the property transfer tax are dependent on the level of the nominal tax rate chosen. At very low rates, these problems may be diminished. But when the tax rate is high, the implications of these problems are magnified. For example, Alm, Annez, and Modi (2004) studied Indian states with different stamp duty rates and found that underdeclaration of sales prices tends to rise with the stamp duty rates.

At its present level of 5 percent, the transfer tax rate in Jordan is higher than in some developing countries and lower than in others. However, it is a temporary rate in Jordan, and the temporary reductions may be removed or continued. A reform option consistent with the goal of reducing the undesirable economic effects of the transfer tax would be to lower the tax rate further. The revenue loss could be recaptured with an increased effective rate of annual property tax.

We might demonstrate this with an example, using 2009 data. A one percent reduction in the annual rate would have generated (all else being the same) revenues of JD 240 million. To recapture this amount of lost revenue from the annual property tax (all else being the same), the municipal rate would need to increase from 10 percent of assessed rental value to 13.8 percent. Under a revalued tax base the increase

would be much less. If one considers the present value of the yearly flow of revenues from the annual property tax, the revenue neutral rate might be even lower.

Replace the Transfer Tax with a Capital Gains Tax

A capital gains tax on property (real estate) would serve the purposes of generating revenues and closing off an avenue of avoidance of income taxes. The base of the tax would be the difference between the sales price of the land and the (adjusted) purchase price. In theory, this is superior to the property transfer tax, which it would replace, because it taxes the profit on the original investment rather than the sales value of the real estate asset. In fact, there is some (but not extensive) use of capital gains taxes on immovable property in low-and middle-income countries.

One might conclude that the tax administration in Jordan is not yet ready to support an effective capital gains tax on real property. Certainly administration is an important constraint. One could be almost certain that notional rather than actual capital gains would need to be used as the basis for assessment. However, the present sales tax system of taxing property transfers would seem no more manageable, and there also, notional values would appear to be used. Given the very great problems with underdeclaration of property transfer values and the equally great problems with individual assessments by DLS, the alternative of a capital gains tax is not so far-fetched.

Wallace (2008) surveys capital gains taxes on real property and finds that most are hybrids that do not tax real gains. Very few of these hybrids are found in developing countries.³² Most developing countries, however, have not adopted capital gains taxes, and they seem comfortable with property transaction taxes. The reason for this might be the fear that a capital gains tax could not be administered, or that it might introduce discrimination in the tax treatment of real estate vs. other assets.

Even with these reservations, a capital gains tax on real estate transfers might be worth considering as an improvement over the present system. It would interfere less with market decisions than the current system, and it could be administered a way that is no more notional than the current system.

Integrate the Transfer Tax and the Annual Property Tax

The proposed draft law for the annual property tax would bring the annual property tax and the property transfer tax to the same base, i.e., the market (capital) value of property. If a program of yearly revaluation of the annual property tax was adopted, the base for the two taxes could be identical for any year of a transaction. In this case, an intriguing idea would be to integrate the two taxes. This would require only that DLS and MOF adopt the same valuation tables.

Such a system would work as described in the following example. Assume two properties A and B of equal market capital value (10,000). Assume that property A is sold and pays a 5 percent transfer tax of 500, and that both A and B pay an equal annual property tax of 100 (at an assumed tax rate of 1 percent).

Property	Transferred (Y/N)	Value	Transfer Tax (5%)	Annual Property Tax (1%)
A	Y	10000	500	100
B	N	10000	0	100
Total		20000	500	200

This simple example suggests some of the advantages of an integrated system of taxing properties.

³² The experiences in Korea and Taiwan are instructive.

1. Only one value for the tax base is required for the two taxes, and the assessment function could be unified. One cadastre could be shared by all parties involved.
2. Economies of scale in appraisal could be captured in areas such as training and certification, coordination of work effort and elimination of duplicate work on the same parcels, and data base sharing. More of the valuation function could be centralized.
3. Because the combined tax is so transparent, undervaluation and evasion would be more difficult.

Another advantage of such an integration is the relative ease of shifting emphasis from the property transfer tax to the annual property tax. One might argue, as above, that such a shift is warranted because of the undesirable effects of the transfer tax on land markets, and the better match between the annual property tax and service benefits received. Moreover, a one percent swap in the tax rates may generate an increased flow of revenues under the new system because the property tax is an annual levy.

Fiscal Decentralization

The fiscal structure in Jordan is highly centralized. Municipal government expenditures are equivalent to 9.6 percent of central government expenditures (2009 data), but none of the major functions of government (e.g., health or education) have been assigned to the municipalities. There is less decentralization on the revenue side of the budget, and most local services are financed by transfers from the central government.

The property tax in Jordan is a central government tax, with about two-thirds of revenue collections assigned to the municipal governments.³³ As noted above, local governments do have some discretion to influence the level of assessment and the collection rate, but they cannot alter the tax rate. The result of this system, as presently practiced, is that the same 15 percent tax rate applies in Amman as in a small municipality. Another noteworthy effect of the present system is that elected local officials are not fully accountable to the population for the level of property taxation that is imposed.

Under a system of fiscal decentralization, local governments would have the power to choose the tax rate and therefore would have to answer to voters about the efficiency with which the money was spent. Moreover, local taxing powers could go hand-in-hand with a hard budget constraint. That is, the responsibility for financing deficits would be put on the municipal government and they would have the power to increase the level of property taxation to cover the shortfall. This would be a step in the direction of moving some local governments (certainly GAM) away from grant financing and toward more own source financing).

While many countries have adopted such a strategy, it is not likely to be successful without safeguards. For example, if municipalities were to be given increased property taxing powers, then the central government would have to accompany this with a grant incentive/penalty to induce them to use their newfound power to increase property tax effort. For example, some portion of intergovernmental transfers to local governments could be made conditional upon achieving a certain level of property tax effort. Elected politicians around the globe are notorious for using central grants to replace higher levels of local taxation. All that said, a well-structured fiscal decentralization strategy, even if applied only to Amman, could lead to a significant increase in revenue and even to more fiscal discipline on the part of the local government.³⁴

³³ The most common definition of a local tax or charge is where the local government has the power to choose the rate of tax (or charge). Otherwise, the revenue instrument is classified as a transfer (Bahl and Linn, 1992). In Jordan, the municipal governments have no authority to set the rate of taxes.

³⁴ For a careful discussion of fiscal decentralization and financing in Jordan, see de Zeeuw (2010).

If the Government took a more modest goal of making the property tax more reflective of the marginal cost of providing services in different local governments, it might move toward imposing a higher (central government) tax rate in GAM than in other municipalities. This could generate significantly more revenue in the municipal area but it still would require the safeguards mentioned above to prevent reductions in collection and assessment rates to offset the higher tax rate.

VI. Summary: Reform Options to Consider

1. Unify the data base used by MOF, GAM and DLS
2. Integrate the transfer tax and the annual property tax, and begin a phase out of the transfer tax; or, lower the property transfer tax rate; or, abolish the property transfer tax in favor of a capital gains tax on real estate.
3. Set a revenue target for the annual property tax.
4. Rethink certain structural features of the annual property tax
5. Remove the preferential treatment of vacant land in the built up zone of urban areas.
6. Drop the 20 percent depreciation allowance in favor of a tax rate adjustment.
7. Move to a system of annual revaluation or indexing.
8. Consider a higher statutory rate for Amman.
9. Procedural Reforms
10. Carry out a regular sales ratio study to determine the relationship between assessed and market value.
11. Establish a monitoring unit for the property tax within the Ministry of Finance or within the office of the Prime Minister.
12. Drop the political membership requirement for the assessment committees in favor of technical qualifications.

VII. Recommended Next Steps

As the government continues to formulate its property tax reform, there are a number of next steps that might be considered. Some of this calls for more thinking through of the difficult choices that must be made, and other involves some needed background research. In many ways, property tax reform is moving in a good direction in Jordan, but much remains to be done before a sustainable, fair and revenue productive system can be put in place. We make four recommendations here for work that could be useful to help the government build such a program.

Recommendation 1: Review Priorities

The government should sharpen its priorities about what it most wants to achieve with the taxation of real property. There is no one set of priorities that is best for all countries. Different countries emphasize different goals, and certainly it is the Jordanian priorities that should inform the property tax structure in the new law. However, sometimes the larger goals of government get lost in the discussion of specific objectives. Government executives might want to consider reviewing their broader priorities.

It might be useful to begin this thinking by laying out the goals that might drive tax reform. Note that some of these are objectives that reinforce one another while others are competing.

1. **Revenue-raising.** This goal might imply setting a target that is higher than the current level of collections, and adjusting the legal rate and base of the tax to hit this target. It also might imply significant improvements in administrative practices and possibly incentives and penalties to improve collections. Another dimension of the revenue objective would be to improve the buoyancy of the tax, i.e., the revenue growth over time. This might lead to more attention to revaluation provisions in the new law.
2. **Fairness.** The goal might be to make the property tax more fair in its treatment of “similarly situated” properties. Unfair taxes – differential treatment of similar situated properties without an acceptable justification – could harm confidence in the overall tax system. A concentration of the reform program on fairness might call for removing any discriminatory treatment of property according to whether it is owned or rented, or whether it is used for industrial or commercial purposes, or whether it is vacant or developed.
3. **Tax burden distribution.** Government might have a primary interest in how the burden of the property tax is distributed among various properties, among owners and renters, among high and low income families, and even among various municipalities. This may lead to calls for a graded property tax where higher tax rates are introduced for certain properties (e.g., commercial) and lower rates for others (e.g., residential). It also may lead to a structure where owners of vacant land are forgiven a significant amount of tax because the goal is to protect them from a heavier burden.
4. **Decentralization.** About two-thirds of property tax revenues are used to finance municipal government services, but there is no local government discretion in determining the tax rate or defining the legal tax base. In some countries, fiscal decentralization is a strategy for increasing the accountability of local government elected officials to their constituents. An important part of this strategy is giving more autonomy to local governments to decide how much revenue they will raise to finance public services. If this were a priority in Jordan (and there is no strong evidence that it is), the new law might contain provision for some degree of municipal government rate setting.
5. **Taxing property wealth.** Another role that the property tax might play is taxing real estate wealth. In effect, those who are property rich but do not have high levels of income, escape the progressive intent of the individual income tax. In the name of equity, the property tax

might be used to capture a “fair share” of taxes from them. In this case, the property tax reform might be structured to equalize the treatment of vacant land with other properties, to increase the rate of the annual property tax rate, to tighten the valuation provisions under the transfer tax, or to consider a capital gains tax on real estate.

6. Improving the efficiency of land use. Some supporters of the property tax might advocate it as a tool to shape a more efficient use of land in the urban area. In this case, removal of the preferential treatment of vacant land might make it to the reform agenda, as might a heavier tax rate on the land component of the annual property tax base.
7. Politics and Culture. Political economy always plays a role in tax reform, usually in the form of significant constraints on what can be done. Sometimes the politics can show up in the choice of priorities from the above list. In other cases, it is more idiosyncratic and focused on specific issues and sometimes on the protection of particular interest groups. Culture also matters, everywhere. The attachment of people to their real estate is different in different countries, and Jordan is no exception here. For example, the seizure of real property for non-payment of taxes appear to be off limits in the enforcement of property taxes in Jordan. Politics and culture will surely play an important role in shaping the priorities for property tax reform.

It is clear that the property tax reform cannot pursue all of these objectives, and in fact some would call for reforms that are contradictory with others. However, it is a clear thinking through of the priorities in Jordan that will provide the basis for deciding on the structure of the property tax. This will inform the provisions to be contained in the new law, and provide the supporting rationale. The government may want to undertake this self-study before it finalizes its recommendations for inclusion in the new law.

Recommendation 2: Sales Ratio Study

Many questions arise about the accuracy of valuations for both the annual property tax and the property transfer tax. Most observers have a guess about the degree of undervaluation, but there is no objective evidence on this. In the aftermath of the reform, and possibly with a new capital value regime, the same questions about the accuracy of valuations will be raised.

It would seem important for the government to either commission or undertake a study of the relationship between assessed and (market) rental values for the annual property tax, and estimated and market capital values for the property transfer tax. The study would involve four steps.

1. Design and draw a representative sample of properties, perhaps concentrating initially on the Municipality of Amman. Sample A would be drawn from all properties, stratified among (a) owner occupied, rented and vacant, (b) residential and non residential, and (c) neighborhoods. Sample B would be drawn from those properties that were transferred during the study period. The two samples would be selected so that there would be some overlap between samples A and B. The sample could be relatively small, since the objectives will be to gather information on the degree of underassessment, and to evaluate the possibility of institutionalizing a process for monitoring assessments.
2. Arrange for independent valuation of all properties in the sample. Likely this will be done by organizing teams of professional experts with a deep knowledge of the Amman area. This might be done through the organization of realtors in Amman. The research probably should be done by a group external to the government, so that the results would be unaffected by any vested interest in showing a favorable or unfavorable result. It would put government valuers in a compromising position if they were asked to grade the accuracy of their own valuations.
3. Carry out an analysis of the data obtained. The goal would be to better understand the several dimensions of the accuracy of valuations. This would include:
4. The degree of undervaluation for the annual property tax and the property transfer tax.

5. The extent to which undervaluation is due to inaccurate valuation tables, inaccurate measurement of properties, or the failure to carry out a timely general revaluation.
6. Whether there are systematic differences in undervaluation, e.g., residential vs. non residential, or owned vs. rented.
7. The reasons for differential valuation of the same properties by DLS and municipalities.
8. The data might also be used to inform property tax policy, e.g., to estimate the revenue impacts of revaluation, or to estimate the impact of a higher assessment ratio for commercial property.
9. While this is a research study, one of its objectives is to determine whether a regular sales assessment ratio should be carried out, and how it might be used. Examples of some information that might emerge from this analysis are:
 10. The cost of carrying out such an analysis on a regular basis.
 11. Determining whether one can separate undervaluation due to faulty valuation coefficients from undervaluation due to poor application of the tables to individual properties.
 12. What to do if the sales ratio study shows significant assessment inequities and significant undervaluation.

Recommendation 3: Feasibility Study on a Unified Cadastre

There is some interest in Jordan (certainly on the part of the Ministry of Finance) in creating a unified cadastre for the property tax. After adjusting the data base to protect confidentiality, a unified data base could be used by DLS, MOF, MOMA, GAM, and all other municipalities. As noted above, this could increase the efficiency of property tax administration.

A next step for government is to study the feasibility of doing such a unification of the data, and to begin the thinking about the kind of MIS system necessary to support the use of this data base. Such a feasibility study is already underway for 93 municipalities under the auspices of the MOF/UNDP study. Now it should be adjusted to take account of the new law, and extended to include GAM.

The TOR for such a feasibility study would be structured around three key questions. The first is about the intended use of the data base, since this would define its structure and content. The data could be used to support the assessment of property by MOF and the 99 municipalities including GAM. Or, it could be used for both valuation and property identification for both the annual property tax and the property transfer tax. Or, it also could be the supporting data base for a computerized mass appraisal system (CAMA).

The second question has to do with whether the various available data can be put together to form a unified data base, and the extent to which additional data will need to be assembled. The following would constitute an initial list for review:

- Identification of all parcels, with unique numbers
- Land maps
- Information about improvements on each parcel
- Subdivision and amalgamation history
- Ownership and billing information
- Information on transactions and transaction values
- Zoning and land use information

- Information on public services available to each parcel (area)

The third question is about how this information could be brought together, the structure of the data base, access and secrecy issues, security, updating, etc. Finally there is the design of an MIS system that would have the flexibility to generate reports and support research, for all users.

The government could either carry out this feasibility study, or commission it. Until this is done (including GAM), not much progress toward developing a unified data base will be made. The timing would seem right to carry out such a feasibility study.

Recommendation 4: Carry Out a Feasibility Study of CAMA

There seems to be a great deal of enthusiasm about the prospects of adopting a computerized system of mass appraisals. The interest in CAMA is widespread across all government agencies dealing with the taxation of property. The scope of work for the present analysis does not include an evaluation of the CAMA proposal. However, there is considerable overlap between this work and the CAMA work in the areas of valuation and data collection. It is important that the feasibility of CAMA be evaluated in a context of the reform of the annual property tax.

There is need for a feasibility study of adopting a CAMA system. While there has already been such a study showing that it is feasible to estimate the relationship between declared values for property transfers and descriptors of location and housing characteristics, there has not been a feasibility study of the broader question of how CAMA can be fitted to the present or proposed new property tax system. In this respect, two issues are particularly important.

The first is that the new property tax law is being drafted with an area-based construction cost approach to valuation in mind. This is very different than a comparative sales approach to valuing property. The question to be considered is whether the CAMA approach is consistent with this valuation approach, i.e., whether the model proposed can lead to a statistical prediction of construction cost. The government might want to consider whether the draft law should be revised to include some accommodation for a computerized (regression) approach to valuation.

The second point is the value data that will be used in the proposed CAMA model. At present, the property values declared to DLS by sellers are used as the dependent variable in the value estimation. These and all other available estimates of value in Jordan are subject to what may be significant, and perhaps even random, undervaluation. It is doubtful that any value data that are now available can give a good estimate of market (capital) value. The question for the feasibility study is to find property value data that can adequately support the CAMA approach, and to reconcile this with the new law.

Table 1
Jordan: Property Tax Revenue
(in JD Millions)

	Greater Amman ^a	Other Municipalities ^a	Total	Percent of GDP
2009	55.1	19.5	74.6	0.46
2008	50.0	18.0	68.0	0.45
2007	44.7	16.8	61.5	0.51
2006		14.3		

Source: Data provided by MOF and GAM. International averages calculated from IMF (various years).

a Includes sewerage and education shares of the property tax.

Table 2
Jordan: Assessed Value of Properties
93 municipalities (excluding GAM)

			Percent Distribution by Type		
	Per Parcel ^a	Owner	Rented	Vacant	Exempt
2010	411	31.1	22.6	42.6	2.7
2009	405	33.7	27.3	37.4	3.1
2008	399	33.9	25.8	37.2	3.1
2007	395	33.7	26.0	37.2	3.3
2006	367	32.4	25.5	38.8	3.2

Source: Data provided by MOF

GAM

			Percent Distribution by Type	
	Per Parcel ^a	Owner	Rented	Vacant
2010	1047	52.8	21.2	25.9
2009	1008	52.1	21.5	26.3
2008	972	52.5	22.1	25.4
2007	920	53.0	23.0	23.9
2006	885	52.3	23.2	24.5

^a Excludes vacant and exempt properties.

Table 3**Number and Percent Distribution of Parcels: All Municipalities**

	Total (in thousands)	Percent in Amman	Percent Distribution of Total		
			Owner	Rented	Vacant
2009	1596	53.8	47.2	15.7	37.1
2008	1517	53.6	47.3	16.0	36.7
2007	1432	53.1	47.6	16.6	36.0
2006	1382	53.0	47.2	16.7	36.0

Table 4**Jordan: Assessed Value as a Percent of GDP**

2009	6.45
2008	6.58
2007	7.63
2006	8.33

Table 5**Revenues from the Property Transfer Tax****(in JD Millions)**

	Total	Percent of Total Central Government Revenue	Percent of GDP	Number of Properties Exchanged (in thousands)
2009	270.3	6.4	1.7	271
2008	379.2	8.7	2.5	290
2007	355.4	9.8	2.9	322
2006	335.1	10.6	3.2	240

Table 6
Population Size Distribution of Municipal Governments

Population Size (in Thousands)	Number of Municipalities
Over 100	10
150 – 100	47
5 – 15	30
Under 5	6

TABLE 7
Revenue Potential of the Property Tax in Jordan:
An Illustration of Revenue Enhancement Measures

Scenario ^a	Collections as a Percent of GDP	Collection Rate	Tax Rate	Assessment Ratio	Exemption Rate	Market Value as a Percent of GDP	Revenue Increase vs. Baseline
Baseline	0.0046	0.7	0.15	0.5	0.75	0.1168	
1	0.0053	0.8	0.15	0.5	0.75	0.1168	1.15
2	0.0069	0.7	0.15	0.75	0.75	0.1168	1.50
3	0.0061	0.7	0.2	0.5	0.75	0.1168	1.31
4	0.0058	0.7	0.15	0.5	0.95	0.1168	1.26
5	0.0133	0.8	0.2	0.75	0.95	0.1168	2.89
6	0.00067	0.8	0.1	0.75	0.95	0.1168	1.45

^a See text for discussion of assumptions.

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