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Property Transfer Taxes

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1. Introduction

The value of property transfers serve as the base of several "other named" taxes including stamp duty, India's tax deducted at source (TDS), estate, registration fee, and simply "transfer tax." Transfer taxes are very old taxes—the Heritage Foundation reports evidence of a tax on property transfer at death as early as 700 B.C.[2] In many developing countries, they comprise a substantial portion of revenue. For example, in Jamaica, the stamp duty (which is largely levied on documents related to property transfer) and property transfer tax proper have been as much as four percent of total revenue (equivalent to 22 percent of the general consumption tax, Bahl 2004). In some countries including the U.S. and India, they are utilized mainly by subnational governments and, as a revenue source, they can be quite important to subnational governments. In Pakistan, stamp duty has accounted for well over 20 percent of own source revenue in Punjab province and more than 8 percent in the Northwest Frontier province (Bahl, Wallace, and Cyan 2015). Among OECD countries, however, transfer taxes are a relatively small source of revenue, but potentially impactful from an economic efficiency perspective.

For purposes of this paper, transfer taxes will be considered as any tax charged on the transfer of property.[3] In particular, we focus on stamp duty on property transfer and property transfer taxes. Transfers may include personal property, intellectual property, and financial instruments (including insurance policies, shares of stocks, and more) as well as real property. In many developing countries, it is the transfer of real property that raises revenue and economic efficiency and equity issues. Transfer taxes have a lot in common with ad valorem property taxes in that they provide a good tax handle, can be relatively easy to administer and comply with, and can provide a reasonable level of revenue (as opposed to simply being a nuisance tax).

In practice, transfer taxes are often layered on/with other taxes and fees imposed at time of sale or transfer of property and they are often in addition to recurring property taxes. This may yield cascading taxes that increase the pay-off to evasion and potentially dampen real estate transactions. The incidence of transfer taxes calls into question their economic neutrality and it ultimately depends heavily on the supply of and demand for property as well as the way the tax is administered and complied with. The intergovernmental aspect of transfer taxes is also a critical issue in the analysis of transfer taxes since different levels of government can overly complicate the system.

[2] http://www.heritage.org/taxes/report/estate-taxes-historical-perspective

[3] Transfers at death via estate type taxes will not be explicitly examined in this paper.

The justification for transfer taxes is itself an open question—do they represent a wealth tax related to ability to pay? Are they benefit taxes associated with some categories of public goods? Are they simply taxes that are relatively easy to collect and part of a patchwork of taxation that reflects the status quo and attempts to capture revenue on wealth that otherwise slips through the cracks?[4] What type of economic impacts do they have? Why have transfer taxes at all in a modern public finance system?

In the hope of highlighting this final question and stimulating discussion about the menu of property taxes discussed at this conference, this paper proceeds as follows. In the first section, an overview of stamp duty and property transfer taxes among OECD and select non-OECD countries is presented while the second section highlights the economic effects of these taxes. Section three includes a short summary of the empirical literature that analyzes the incidence of these taxes (almost exclusively in OECD countries) and the final section provides a discussion of the pros and cons of retaining these taxes as part of public finances around the globe based on the characteristics of a good tax (equity, efficiency, administrative and compliance burden, and revenue adequacy) and offers some suggestions for transfer tax reform.

2. Stamp Duty and Property Transfer Taxes Rates, Bases, and Trends

Stamp duty and property transfer taxes are idiosyncratic, making it quite difficult to present details of bases, rates, and tax administration. Some very general similarities include the notional tax base (which in most cases is the value of property that is transferred) and economic implications resulting from an increase in the cost of real property transactions. Comparative revenue data are also very difficult to obtain, so much of the analysis included in this paper is the result of field work over the last two decades in a handful of countries.

In general, stamp duty is a fee for service associated with the government recording and legitimization of a transaction. Stamp duty has been around for centuries and occupies a special place in U.S. history. The Stamp Act of 1765 imposed a stamp duty on American colonists that was used in large part to sustain the development of British armed forces in the colonies. The Act, in part, led to the famous cry of "taxation without representation" and increased ill will between the colonists and the British crown.

Stamp duty may be charged on a wide variety of documents, and transfer of property is one. In countries including India, Pakistan, and Jamaica, the stamp duty associated with property

[4] Such wealth might include capital gains on real, personal, and financial assets if there is weak income tax administration or exchanges of assets between related parties, among others.

transfers is a large (if not the largest) share of stamp duty revenue. The tax base of stamp duty is often the declared value of the property transfer and is sometimes corroborated with secondary information on property valuation.

Property transfer taxes are taxes levied on the transfer of property and are typically based on the market value of transferred property. In some developing countries, a reasonable estimate of the market value is hard to come by and in lieu of documented market valuation, a self-reported value of property may be used. Bahl (2004) documents the validation process for market value in Jamaica. An independent analysis of the market value is done by government valuers using transactions from the Stamp Office database. Comparisons are made among “similar” properties to determine whether or not the self-reported valuation is in line with past recorded sales. The process is hamstrung by the use of previously reported data, which was developed using the same judgmental process and high caseloads. The result in Jamaica has been the continuation of recording property values at a “discounted” level.

Tax rates for these levies vary widely among countries and within countries. Table 1 provides some examples of the differences in rates and bases for a selected sample of countries. The U.S. is an interesting case in that most states impose some sort of transfer or stamp-like tax on property transfers. The Lincoln Institute of Land Policy provides a comprehensive list of these taxes by state.[5] Some states (Arizona, Alaska, Idaho, Indiana, and Mississippi, among others) have no transfer tax, while other states such as Hawaii have complicated progressive taxes, with the effective rates increasing with the value of the transfer. Some states use a specific levy (dollar of tax per some dollar amount of transaction) while others use ad valorem taxes. The system of transfer taxes in the U.S. provides substantial variation that has been used in various empirical studies to ascertain economic effects including the impact of property sales and turnover.

Table 1: Transfer Taxes: Illustrative Country Examples

Country	Base	Transfer tax rate
US (California; local option)	\$.55/\$500 value of property	0.11%
US (New York)	\$2/\$500 value of property	0.4% up to \$1 million; 1.4% over \$1 million
Canada (Ontario)	Total property value	Sliding scale of 0.5% to 2.0% based on value
Spain	Value of transferred property	6% (with local variation)

[5] https://datatoolkits.lincolninst.edu/subcenters/significant-features-property-tax/Report_Real_Estate_Transfer_Charges.aspx

UK	Value of property greater than threshold	Sliding scale from 2% to 12% based on value
Belgium	Value of property	Up to 12.5% based on value
Peru	Agreed upon price	3%
South Africa	Value of property greater than threshold	Sliding scale from 3 to 13% based on value
India	Value of property	Rates vary by state and range from 4 to 10%
Hong Kong	Value of property	Sliding scale from 1.5 to 8.5 % based on value

Sources: US NCSL http://www.ncsl.org/research/fiscal-policy/real-estate-transfer-taxes.aspx
Spain: http://www.cfe-eutax.org/taxation/taxation/propety-taxes/real-estate-transfer-tax/spain
UK https://www.gov.uk/stamp-duty-land-tax/residential-property-rates
Belgium: http://www.cfe-eutax.org/taxation/taxation/propety-taxes/real-estate-transfer-tax/belgium
Peru: https://www2.deloitte.com/content/dam/Deloitte/pe/Documents/tax/tax_guide%202014-rev.pdf
South Africa: http://www.sars.gov.za/TaxTypes/TransferDuty/Pages/default.aspx
Hong Kong: http://www.gov.hk/en/residents/taxes/stamp/stamp_duty_rates.htm

As an additional illustration of the potential complexity of the various transfer taxes, Table 2 reports the various taxes on property transfer in the North West Frontier Province (NWFP) and Punjab Province of Pakistan. As noted in the table, multiple taxes are levied and three layers of government are involved in the taxation of property. As presented in Bahl, Wallace, and Cyan (2008), this proliferation of rates and levels of government has led to a system that is onerous to taxpayers and to the tax administration and yields relatively low levels of revenue.[6] Jamaica represents another case study in complexity whereby the government imposes a stamp duty on transfer of 3 percent of the declared value and an additional transfer tax of 4 percent. These rates have been substantially reduced from 5.5 percent and 7.5 percent respectively. The rate change is quite recent and there are no collections data yet available to discern the revenue impact of the rate reductions.

[6] In Pakistan, there are in fact additional taxes on land including an agricultural income tax and a land tax. These additional property type taxes are found in many countries.

Table 2: Taxes on Property Transfer Pakistan

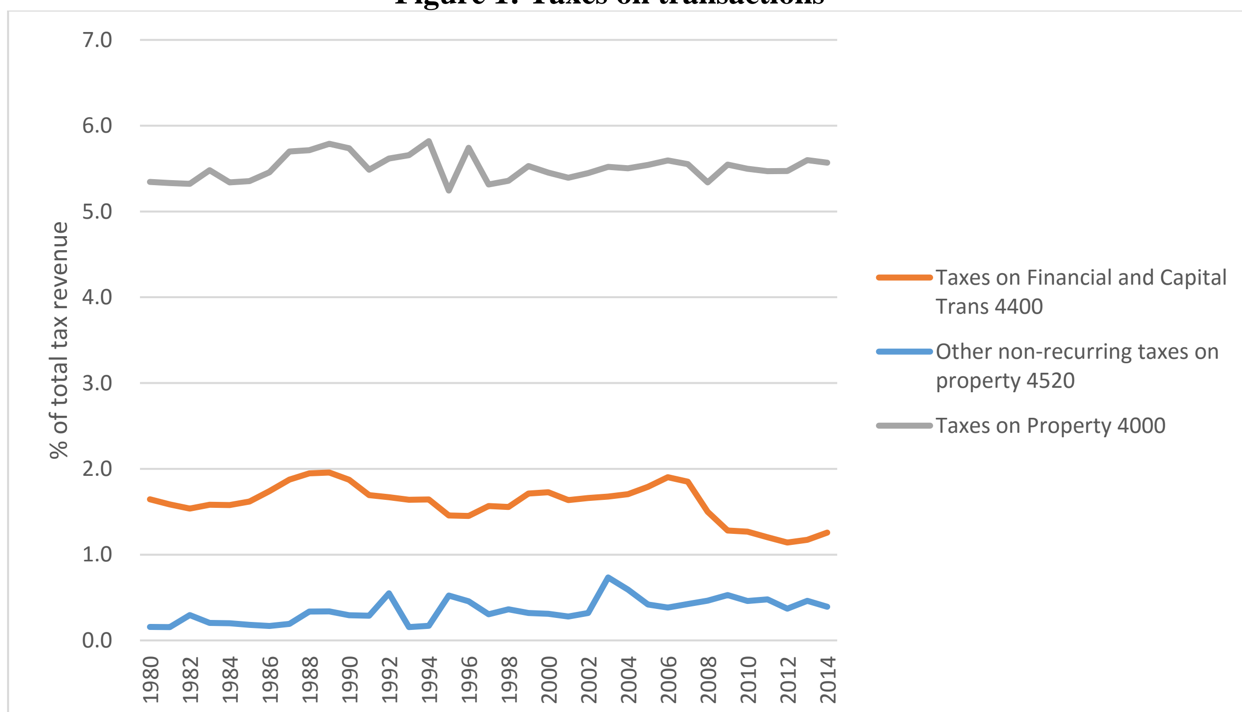
Tax (Government)	Rate as % of value Punjab	Rate as % of value NWFP
Stamp Duty (Province)	3	3
Registration Fee (Province)	Specific rate	2
Capital Value Tax (Province)	2 or per sq.ft. of developed area (Urban areas)	2
Tax on Transfer (Local)	1	0.5
Capital Gains Tax (Central)	0, 1, 3	0, 1, 3
Total	**10 (max)**	**10.5 (max)**

Note: Capital gains tax is levied on properties sold within three years; rate is 3% if sold within a year, 1% if sold between 1 and 2 years; 0% if sold after 3 years, Sources: Bahl et al (2008), Punjab Board of Revenue.

In India, the various taxes imposed at time of transfer include: stamp duty, VAT, tax deducted at source, service tax on property (for property under construction), and capital gains tax. The stamp duty alone can top 10 percent (depending on the state), while the other taxes can add an additional 7 percent or more to the cost of the transaction. As with the other examples presented here, the high level of taxes engaged at time of property transfer will encourage tax evasion/avoidance behavior.

It is very difficult to find comprehensive data on the level of property transfer tax revenue among countries. While the taxes are important to governments, they are relatively small compared to other taxes and revenue figures are typically rolled into other categories including general "fees" (US) or "property taxes" (OECD). Figure 1 presents tax revenue data for OECD countries including all taxes on property (classification number 4000 in the OECD database), taxes on financial and capital transactions (classification number 4400), and other non-recurring taxes on property (classification number 4520). Real property transfers are potentially included in the latter two categories, which also include other financial transactions. As a share of total tax revenue, these transfers are a maximum of 1.7 percent of total tax revenue and 0.6 percent of GDP. Some countries rank much higher. In Korea, for example, taxes on financial and capital transactions account for 7 to 8 percent of total tax revenue.

Figure 1: Taxes on transactions



Source: OECD revenue database: https://stats.oecd.org/Index.aspx?DataSetCode=REV

In the state of Georgia (U.S.), property transfer tax is applied at the time of a new or refinance mortgage filing. Revenue from the transfer (transaction) tax is classified with "other taxes and fees." In FY16, the total of this category of state revenue was $28 million, out of a total state budget of over $19 billion.

Among developing countries, data on transaction taxes are much more difficult to come by other than on a case-by-case basis. As previously noted, in Punjab, Pakistan, the stamp duty (largely on property transfer) accounts for a substantial portion of provincial own-source revenue (19.8 percent in 2006). In India, stamp duty and registration duties amounted to 6.2 percent of all state revenue in 2003 (Alm et al, 2004). At the subnational levels of government, if these taxes are considered own-source revenue, they *could* represent substantial levels of revenue but the tax effort in many developing countries is lquite low. Bahl et al (2008) estimate that in Lahore Pakistan, assessments, which equate to the base of property transfer taxes, were consistently as much as fifty percent below actual market value. This suggests that tax capacity is much higher than present collections. Whether political will exists to deal with the low effective rates of transaction taxes is an important open question.

A remaining policy question is whether the cost of transfer taxes in terms of economic impact is worth the level of revenue that could be generated if valuation rolls were improved and the compliance was shored up. We turn to these economic considerations in the next section.

3. Economic Implications: Dimensions of Tax Policy

An evaluation of a revenue source may be made along several paradigms including: equity, economic efficiency, ease of administration and compliance, and revenue adequacy.[7] Equity refers to the fairness of a tax and is generally taken to mean whether or not the tax is horizontally or vertically equitable. *Horizontal equity* refers to the "equal treatment of equals." For example, if two properties in a similar location with similar characteristics are taxed differently due to exemptions or poor valuation practices, the tax would not be horizontally equitable. *Vertical equity* refers to the treatment of individuals with different levels of income. If a tax is progressive, this is normally considered vertically equitable.

Economic efficiency refers to the impact of a tax on relative prices, which may induce individuals (and businesses) to react differently than they would without the tax. For example, if the stamp duty were significantly lower on certain types of properties, the cost of transfer for those properties would be lower than other properties. This could shift behavior toward large turnover of properties that are more lightly taxed. Or—individuals could choose to forgo property turnover entirely or for longer periods of time to avoid the tax. In general, the more a tax affects behavior, the more costly it is in terms of economic efficiency.[8]

Another basic principle is that a good tax is one that imposes relatively *low compliance and administrative burdens* and produces "adequate" revenue. *Revenue adequacy* is somewhat subjective—it frames the idea that a tax that raises very small amounts of revenue and imposes costs in terms of administration and compliance is not a good tax.

How do the stamp tax and property transfer tax rate on all of these standards of a good tax?

- *Vertical Equity* – The incidence of taxes on property (which is the base for the stamp duty and other transfer taxes) depends on the demand and supply of property. If property is highly demanded and in short supply, the entity purchasing the property will be willing to pay a premium, including the stamp and transfer tax, to get the property. This is true regardless of which entity (buyer or seller) is statutorily

[7] Martinez-Vazquez, J. (2001). Mexico: An evaluation of the main features of the tax system.

[8] This is strictly true when there are no other taxes or existing externalities. In the presence of externalities, other taxes, and other behaviors (a second best case), a tax on properties may have impacts on other markets including other capital that could further reduce efficiency or even enhance efficiency.

responsible to pay the tax. If property is not highly demanded, the seller of the property may have to absorb the tax in the form of a lower sales price. Under the assumption that most property is bought and sold by those higher in the income distribution, the burden of these taxes is likely to fall on higher income individuals. This may be seen as vertically equitable if the tax is properly administered.

- *Horizontal Equity* – The statutory treatment of similar properties is the same in the case of the stamp duty and transfer tax on property transfer, thus being horizontally equitable. In practice, due to the difficulty in valuing properties, there may be inequities across similar properties because of the value reported at transfer. In many countries, the revenue authority does not have a mechanism to compare and value properties adequately. This indicates that there is a possibility of similar properties being treated differently within a jurisdiction which is the definition of horizontal inequity. This in turn can undermine the taxes as inequities reduce tax morale and can lead to a reduction in compliance. Some countries, including Pakistan, have additional transfer type taxes on urban (versus rural) property, which gives rise to additional differences in treatment.

- *Economic Efficiency* – The stamp duty and property transfer tax change the total price for property that is sold. Since these taxes are incurred at the time of transfer, individuals who may otherwise sell a property in the absence of the tax decide to hold onto the property (or try to evade the tax).[9] The tax structure may also impose excess burden[10] through distortions in the market for property (including a preference for foreign property or holding property longer than desirable for development) although some studies find the effects to be short lived.[11] A high rate of stamp duty may also distort housing ownership.[12] This type of lock-in effect can

[9] For example, see Dachis, B., G. Duranton, and M.A. Turner, (2011), "The effects of land transfer taxes on real estate markets: evidence from a natural experiment in Toronto."
[10] Kopczuk, W., and D.J. Munroe, (2014), Mansion tax: the effect of transfer taxes on the residential real estate market.
[11] Besley, T., N. Meads, and P. Surico, (2014), "The incidence of transaction taxes: Evidence from a stamp duty holiday."
[12] Wood, G., R. Ong, and I. Winter, (2012), "Stamp duties, land tax and housing affordability: the case for reform."

be detrimental to economic growth.[13] In addition, if properties are effectively taxed at different rates (horizontal inequity), efforts may be made to transfer more lightly taxed property or to evade the tax by reducing the valuation of the property.

- *Administrative and compliance burden* – One of the primary benefits of a stamp duty and property transfer tax is that they can be relatively easy to comply with and can be easy to administer. The taxes provide a good "tax handle" since property and its transfer should be identifiable by means of appropriate documentation. The availability of an accurate valuation of property is one of the necessary conditions of a smooth functioning set of taxes. In practice, in various countries payment of taxes on transfers requires the taxpayer to visit multiple offices, which adds significantly to compliance costs. In Punjab, the compliance costs have been considerably reduced by a recently instituted e-stamp system. But the costs of visiting various locations for each one of the taxes still remain. The myriad property taxes must also be paid, requiring additional steps for the taxpayer and tax administration.

- *Revenue adequacy* – The base of the stamp duty on property transfer and other transfer taxes offers the potential for significant revenue, even at low tax rates. Undervaluation of property reduces the actual collection of these revenue sources in countries including Jamaica and India.

- *Principle for taxation* – Taxes can be justified based on ability to pay and/or benefits received. Ability to pay refers to taxation that is commensurate with the ability to pay tax to government. It is usually referred to as equity argument for taxation. Benefit taxation refers to taxation that is commensurate with benefits received—"paying" taxes to receive some level of public good. Abstracting from the issues of specific and general benefits and valuation of those benefits, under the benefits principle, taxpayers should be able to identify public goods and services that they are willing to pay for. There is a long-standing debate regarding the justification of general property taxes—are they ability to pay or benefits taxes? In the case of the

[13] A 10 percent increase in stamp duty, for instance, has been found to decrease transactions by 3 percent (Davidoff, I., and A. Leigh, (2013), "How do stamp duties affect the housing market?")

stamp duty, if the fee is relatively nominal and covers the cost of legitimizing documents, a taxpayer might see justification for the stamp duty. In practice, the statutory fee is often not nominal. In Jamaica, for example, the stamp duty is 3 percent of the value of transfer. The lack of uniformity among stamp type duties in US states, suggests a disconnect between the benefit of the stamping and cost (for example, $0.01 per $100 value in Colorado and $1.50 per $500 in Georgia). As an ability to pay tax (wealth tax of sorts), the ad valorem nature of many transfer taxes is somewhat consistent with ability to pay. The complication is that the proliferation of property taxes (recurring as well as one-time transfer) potentially creates a substantial burden that is difficult to tie back to services received.

Relative to the principles of a good tax, the stamp duty and transfer taxes have much to recommend them in theory: good tax handle, potential for substantial revenue, and vertical equity. However, in practice, there are several economic and administrative issues with the system of stamp duty and transfer taxes among countries. For example, an analysis of transfer taxes in Punjab Pakistan including stamp duty and property transfers (Bahl, Cyan and Wallace 2008) highlighted that the main problem regarding transfer taxes is that property transfers are not being taxed at their market values.

The multiple levels and layers of tax on property raise the overall effective tax rate on some transferred properties to very high levels. This represents a substantial burden on the transfer of property and will naturally lead to tax evasion and avoidance behavior. The most obvious form of evasion is under declaration of value, which occurs throughout Pakistan (Bahl et al 2008) and Jamaica (Bahl 2004), as well as other countries. In other cases, the relatively high level of transaction costs associated with the taxes may reduce the efficiency of the real estate market. The empirical evidence on the effects of these taxes suggests impacts on turnover, pricing, and burden and we turn to a summary of that literature next.

4. Empirical Literature

There is a small but important literature that empirically examines the impact of transfer taxes on tax burdens, real property tax prices, and property turnover (among other impacts). Most of this work has been done in developed countries but it does shed light on the overall economic impact of these taxes, which will be similar in developed and developing countries. In this section, a brief review and summary of that literature is presented.

Davidoff and Leigh (2013) estimate the impact of stamp duty in Australia on housing prices and turnover using a 13 year panel of home sales. Stamp duty in the country averages 3 percent of the property value at the time of sale and there is variation in stamp duty rates over states and territories and over time. Using a variety of econometric techniques, they find evidence that the stamp duty does two things: it lowers house prices and reduces turnover. These impacts are significant (price elasticity of 0.3 and a reduction in turnover by 6 percent over a three year period) and point to a burden of transaction taxes on the seller.

In Toronto, the imposition of a new 1.1 percent land transfer tax in 2008 was used to exploit a natural experiment in the real estate market. Dachis, Duranton and Turner (2011) estimate that the tax change gave rise to a very large decrease in sales (15%) soon after the new tax was imposed. The price effect they found is much more muted—on the order of 1 percent (unit elasticity). The decrease in sales yields a substantial welfare cost based on their estimates (approximately $20 million in lost welfare).

Kopczuk and Munroe (2014) also used a natural experiment to estimate the impact of transfer taxes on the housing market. A "mansion tax"—additional tax on properties over $1 million--was instituted in New York in 1989 and in New Jersey in 2004. The authors employ a discontinuity analysis in which they analyze sales behavior below the "mansion notch" and above. They find evidence of missing sales above the notch and conclude that the differential transfer tax reduces the turnover of more expensive homes (all else controlled for). They also conclude that sellers reduce their price (in the vicinity of the notch) to avoid the additional tax, as might be expected.

Another natural experiment is used by Besley, Meads, and Surico (2014) to identify the impact of transfer taxes on the real estate market. In this case, a stamp duty holiday in the United Kingdom is used to identify the impact of the tax on sales prices and the level of transactions. Similar to the other papers (in the reverse direction), transactions increased but housing prices dropped (a boon to buyers and different from the previous studies). However, the authors conclude that the impacts are relatively small, including the welfare cost of the stamp duty.

Finally, a very recent paper based on the German real estate transfer tax, which was transferred to the German states in 2006, examines what happened to real estate in that market. The transfer tax rates vary from 3.5 to 6.5 percent of the value of the transfer (much higher than rates in the previously mentioned studies). Petkova and Weichenrieder (2017) find that the tax reduces turnover with an elasticity of 0.23 but they do not find a significant impact on prices.

The theme from these empirical papers is consistent—transfer taxes in OECD countries reduce housing turnover with elasticities from approximately 0.4 to well over 5. However, many of

these are short and medium term impacts. They also impose welfare costs that are significant. The impact of transfer taxes on housing prices is a bit less clear and the price elasticities are less than one. These results merit further analysis and research as they are not always consistent with expected market effects. Additionally, the void in empirical analysis in developing countries hampers our ability to generalize results further.

5. So-Why have Transfer Taxes?

Is there room/need for transfer taxes in public finance systems? At one level, the answer is "yes." There is need to legalize documents and make sure they are filed and retained and a government stamp is one way to accomplish this task. Covering the cost of stamping with a levy also makes sense. Experience suggests however that stamp duty levies are charged well above the cost of the service. In addition, coupled with property transfer taxes, the statutory cost of transfer of real property is very high in many countries and there is evidence that they disrupt real estate markets. These issues bring into question why the taxes remain in many countries.

Even with high statutory costs, efficiency costs, and concerns about equity and transparency, transfer taxes remain for some obvious reasons.[14] First, transfers are an easy tax handle and second, the cost of collection may be low. Growth in property value can add substantially to government coffers making these taxes potentially important sources of revenue. Also, if property ownership is concentrated in the higher income classes, the distribution of tax burdens may be progressive. In addition, relatively few people trade property in a year and so the tax administration is manageable. Last, a property transfer tax might reach that part of the population that ordinarily avoids payment of most income tax and value added taxes.

At the same time, as discussed above, the transfer taxes have significant disadvantages as well. The empirical literature surveyed points to important implications of property transfer taxes including turnover and price impacts leading to a loss in economic efficiency. In addition, field work in several developing countries suggests that stamp duty and property transfer systems lead to undervaluation of property and encourage tax evasion and avoidance. Transfer taxes are non-recurrent taxes on property yet they are not necessarily tied to obvious local benefits in many countries. As an ability to pay type tax, they may be a rather blunt instrument of progressivity if valuation rolls are not up to date. There are other taxes on property that may

[14] Bahl, Wallace, and Cyan (2008).

address the main principle of taxation—whether it be an ability to pay tax or as a benefits type tax.

What sort of policy reforms might a country consider in regards to transfer taxes? There are at least three general options:[15]

- Retain stamp duty but at a relatively low (cost-reimbursement) level
- Retain the transfer tax at a low rate and supplement the tax with a serious attempt to corroborate reported values
- Abolish the transfer tax (Blochliger, 2015, Norregaard, 2013, Bahl et al 2008) and replace it with a capital gains tax

Serious reform options focus on the transfer tax while leaving a relatively small stamp duty in place. In various countries outside the OECD, the transfer tax is a blunt wealth tax instrument. The undervaluation of the base prevents it from being a serious ability to pay tax. As it stands, transfer taxes in many countries do not tax capital gains since valuation is often haphazard and somewhat ad hoc. An additional reform option for consideration is whether transfer taxes should/could be replaced by recurrent taxes on real property. Norregaard (2013) reports that this movement is afoot in Ireland and Portugal and that the Fiscal Affairs Department of the IMF does not advocate for traditional transfer tax policy (stamp duty and property transfer).

A capital gains tax on property as a substitute for transfer tax might be developed as follows (Bahl, Wallace, and Cyan 2008). Capital gains taxes on property are not unknown in developing economics. They are levied, for example, in Columbia, Korea, Zimbabwe and Taiwan. However, the implementation of a capital gains tax on real property raises some serious administrative issues. As the international practice shows, there are a number of important issues:

- How would records of the original selling price be documented and verified?
- How would records of the increase in basis be kept and verified? For example, records would be required to show the cost of improving properties to enhance the selling price.
- Would there be an inflation adjustment?
- How would inter-family transactions be handled?

[15] In addition, consideration should be given to collapsing property transfer taxes into one instrument in countries like Pakistan where there is a proliferation of taxes on transfers.

These are thorny issues that deserve consideration. In theory, the concept of a capital gains tax on real property is straightforward. The tax liability would be taken on the difference between the buying and selling price of the property, indexed for inflation. The buying price (base) would be set according to historical records of purchase price. Owners could petition to have this base increased, for reason, but if successful would be liable for payment of the proper amount of transfer tax on the original transaction. The selling price would be verified by the valuation staff in the capital gains tax office. Note, however, that there would be a self-enforcing feature.[16] The nominal gain would be adjusted for inflation and for the cost of allowable improvements to the property (e.g., irrigation).

A major drawback of a capital gains tax is administration, especially establishing the basis for a capital gains tax, and developing a method for indexing for inflationary increases and adjusting for qualified investments in real property. As complicated as these administrative requirements seem, they are not any more daunting than the present requirement of establishing a true market values for every real estate transaction.

Such a tax system would have appeal. Revenues would not ebb and flow with market activity, capital gains rates could be adjusted for urban versus rural property, and the number of different taxes levied on real property could be reduced if these reforms were rolled into overall property tax reform. The incentives for underdeclaration of property prices at the time of sale would be lessened. The result might be a better flow of information about land prices, which is necessary to develop a property market.

Another choice for elimination of the transfer taxes is to eliminate the stamp duty and property transfer tax on property sales, and bring residential real estate transfers under the value added tax. Buyers and sellers would have an incentive to report correctly, and a more accurate flow of information about land values would result. The tax would be levied at the standard VAT percent on the selling price of land, less the (real or notional) tax paid on the purchase price. For some sales, the tax burden would be well below that of the current rate on total transaction value.

This would violate the notion of a VAT as a consumption tax since housing is consumed over many years. The practice varies widely among the industrialized countries. Some cover certain types of property sales under the VAT (e.g., new vs. used buildings as in Germany and Belgium), some use a transfer tax much as Pakistan does and zero rate new buildings (UK),

[16] Buyers would have a disincentive to underdeclare the purchase price because their basis for a future tax on gains would be too low.

and there are numerous types of special treatments and exemptions. A good discussion of the treatment of real property under the VAT is in Bird and Gendron (2007, p8-86).

Or—the transfer taxes could remain as is. They generate revenue, although much less than their potential, they distort economic activity, although less than some other taxes including corporate income taxes, and they are “known.” In the interest of advancing good tax policy and in the context of the overall system of taxes on property, it is certainly worth considering the elimination of transfer taxes as they currently stand in many countries.

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