8. Real Property Taxation in the Philippines

Local governments in the Philippines are vested with the power to create their own revenue sources. Such power must of course be exercised within the limitations set by law. The Local Government Code of 1991 allocated the taxing powers among local government units to prevent double and multiple taxation. A ceiling on the tax rates is also provided under the law. National policy thus sets the tax base (and the valuation rules) as well as the limits for tax rates.

The power to impose the real property tax has been given to provinces, cities, and municipal governments within the Metropolitan Manila area. The tax applies to all forms of real property such as land, building, improvements, and machinery. Exemption is given to real properties owned by government, charitable institutions, churches, cooperatives, and those that are used in the supply of water and electric power. Equipment for pollution control and environmental protection is not subject to tax.

The base of the tax, or the assessment level, is only a fraction or a percentage of the market value of the land. The under-taxation of land is therefore built into the tax structure. This is compounded by assessment levels that are differentiated depending on land use:

<table>
<thead>
<tr>
<th>Land use</th>
<th>Assessment Levels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>20%</td>
</tr>
<tr>
<td>Agricultural</td>
<td>40%</td>
</tr>
<tr>
<td>Commercial, Industrial and Mineral</td>
<td>50%</td>
</tr>
<tr>
<td>Timberland</td>
<td>20%</td>
</tr>
<tr>
<td>Special classes: cultural, scientific</td>
<td>15%</td>
</tr>
<tr>
<td>Hospital, and water districts</td>
<td>10%</td>
</tr>
</tbody>
</table>

The assessment levels for improvements are also differentiated based on land use and market value. For example, residential houses with a market value of $3,500 are exempt. Residential buildings with a market value of $194,000 and above are taxed on 60 percent of market value. Similar buildings are taxed at 80 percent of market value if they are used for commercial or industrial purposes. The different assessment levels can

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1 Prepared by Milwida Guevara, Ford Foundation, Manila.
2 Machinery is assessed at 80% for commercial and industrial, 50% for “residential,” and 40% for agricultural.
distort decisions on resource allocation. For example, since farmlands are taxed more heavily than residential lands, there is an incentive rather than a disincentive to convert farmlands into residential subdivisions.

The local legislative councils are mandated to legislate the assessment levels to be used in their localities. However, these cannot exceed the maximum levels that are authorized under the Code.

The Code also sets a minimum rate of 0.25% (0.5% for cities) and maximum rates that can be imposed on real properties:

<table>
<thead>
<tr>
<th>Taxing Authority</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Province</td>
<td>1%</td>
</tr>
<tr>
<td>City and Municipality in Metro Manila</td>
<td>2%</td>
</tr>
</tbody>
</table>

Under the principle of fiscal autonomy, assessment levels and tax rates can vary among different local government units (LGUs) as long as they are within the ceilings that are prescribed under the law. In Quezon City in 2002, for example, the basic real property tax rate was set at 2% for commercial and industrial property and 1.5% for residential property. Generally, the maximum rate is imposed by LGUs and a uniform tax rate is maintained on land and improvements. Of course, with the differential assessment ratios noted earlier, the “effective” rates vary by property class, up to a maximum of 1.6% (80% of 2%).

**Property Valuation.** As in the case of many internal revenue taxes in the Philippines, real property taxation relies heavily on self-declaration of landowners, particularly in rural areas. The Code requires them to declare their properties before the office of the provincial assessor once every three years. The local assessor then prepares the assessment roll that contains a list of all properties in the LGU and their current market value. Property values are in accordance with a schedule that the assessor prepares for different classes of real properties. In theory, the process should be guided by principles of equity and uniformity. The provincial legislative council then enacts the schedule of

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3 The province is composed of a cluster of municipalities and component cities. The provincial government is responsible for providing tertiary health services, agriculture extension services, and enforcement of laws on environment, social welfare services, and provincial infrastructure. The municipality is composed of a cluster of barangays (villages) and is responsible for primary health care.

4 Every owner or administrator of property is required to file every three years. This reliance on self-assessment is despite earlier major reform efforts to introduce accurate official valuation methods which at the time were considered “quite successful” (Roy Kelly, “Property Tax Reform in Southeast Asia: A Comparative Analysis of Indonesia, the Philippines, and Thailand, Journal of Property Tax Assessment and Administration, vol. 1 (no. 2, 1995), p. 64). Although the USAID-funded Real Property Tax Administration Project from 1981 to 1991 resulted in a substantial increase in the tax base – interestingly, mainly by revaluing property already on the rolls rather than adding new properties – in the end it had relatively little effect on yields. Moreover, as noted in the text, it seems to have little lasting effect on valuation practices. [Note added by editors]
values into an ordinance, although practice varies in this respect. Provinces thus establish both valuations and rates, and provincial legislatures determine revaluations.

Lands are valued by provincial assessors following rules and regulations issued by the central government, i.e., the Department of Finance. Land is generally valued using the comparative sales approach, although apparently often for current uses. Assessors use information on recent sales of similar properties, with adjustments to compensate for differences on location or topography. Buildings on the other hand are valued using the replacement cost method. An estimate of the costs of replacing the property with similar materials is made with an allowance for depreciation. Machinery is valued using the original invoice value with an allowance for depreciation. The market value of the produce is used as a basis for the valuation of agricultural improvements.

Properties are classified in accordance with their actual use. In cases where there are mixed land uses, the predominance rule is applied.

Since revaluation of properties is done only once in three years, values are generally behind current values. Other factors pull down the values. The mean or average value of properties in a locality is used in preparing the schedule. Comparative sales data are also sparse and inaccurate. Property owners tend to under-value properties to escape paying a high tax on “capital gains” (actually on transfer value – see below). There are also chronic inadequacies in tax administration such as lack of assessment tools and absence of technically qualified personnel. There have been investments in tax maps and computerization in select LGUs, but these programs have been heavily reliant on support from foreign donors.

The system for monitoring and recording of land transfers can stand significant improvements. Although the Code requires the Register of Deeds, Notaries Public, and Building Officials to submit documents on property transfers to the assessor, this is better said than done. Thus, assessors generally rely on the volition of taxpayers to present instances of land transfers.

Property valuation has also become political because assessment levels and the schedule of market values are legislated by local councils. Taxpayers may appeal within 60 days to Local Boards of Appeal and further to Central Board of Appeals, and there are reportedly many court challenges. In addition, it is common to have public protests against revaluation and extensive lobbying for preferential tax treatment accompanying legislation.

**Collection of the Real Property Tax.** The tax starts to accrue on the first of January every year and can be paid in four installments before the office of the local treasurer on or before the end of each quarter. A discount (10% or sometimes 20%) is available to taxpayers who pay the tax in advance while late payments are subject to a two percent (2%) surcharge per month, to a maximum of 36%. Provinces collect the tax, although they often delegate this function to local treasurers.
In more developed LGUs, tax payments are computerized. But in many LGUs, recording of tax payments is done manually. Treasurers maintain alphabetical records of taxpayers and their payments. These are intended to be reviewed quarterly so that letters of demand can be sent to delinquent taxpayers. The Code vests LGUs with the power to sell delinquent properties through public auction. Although the exercise of this power has produced positive results, its use has still to gain wide acceptance. Treasurers are more disposed to the use of traditional methods of collection such as demand letters. This attitude is not at all different from the relatively soft approach of the national government on the prosecution of tax evaders.

As a result, the low revenue performance of the real property tax does not come as a surprise. The effective tax rate or the ratio of the actual collection to the tax base, or the assessed value was estimated at 0.75 percent compared to a statutory rate of one percent (1.0%) for provinces and two percent (2.0%) for cities. If tax collection were related to market values, the ETR dips to 0.067 percent implying that the realty tax paid by taxpayers is only P0.07 for every P100.00 of market value.\(^5\)

The ratio of actual collection to collectibles is at an average of 47.0 percent for cities, 54.0% percent for provinces and 77.0 percent for municipalities. LGUs were only able to collect one-half of the real property tax that is due them.\(^6\)

**Importance of the Real Property Tax as a Revenue-Source.** The real property tax is the most important tax revenue of local governments. In the eighties, it accounted for 23 percent of total revenues of local governments. Its relative importance started to decline in 1990 to 18 percent and dropped in 1994 to 11.0 percent. Thereafter, it picked up strength and now accounts for 13.36 percent of total revenues of LGUs.

The decline in the revenue importance of the real property tax is brought about by the increase in grants to LGUs from the central government. Prior to the devolution program in 1991, the share of LGU from internal revenue taxes was only 20 percent. The contribution of grants had since gone up to 40 percent.

Collection grows at an average of 18 percent annually. Since revaluation is only done once every three years, the normal increase is brought about by collections from improvements on land and collection from delinquencies.

The real property tax effort of LGUs or the ratio of the real property tax (including the SEF, described below) to GDP in 1999 was 0.48 percent. The rate elasticity or the ratio of the growth in revenues to the growth in tax base is almost unitary implying a constant or very marginal increase in collection efficiency among LGUs. Base elasticity or the degree of responsiveness of the base to changes in national income is less than unity, which indicates that the tax base lags behind the growth of national income.

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\(^6\) Ibid.
Sharing the Pie. Collections from the real property tax are shared with smaller local government units that compose the province or the city. In the case of a province, 40 percent goes to the municipality; 25 percent goes to the village where the property is located, and the province retains 35 percent. Collections of city governments are divided with the village getting one-third and the city retaining two-thirds.

The political underpinnings of the devolution program have yet to be empirically analyzed. The Code stripped municipal governments with the power to impose the real property tax. Provincial governments now determine property values and tax rates.

Other Land-Based Taxes. A Special Education tax (SEF) of one percent is imposed on the same base, i.e. assessed values of real properties. The proceeds are earmarked for public education. (The yield of this tax is included in the revenue figures reported earlier.)

Local governments are also empowered to impose an idle land tax and a special levy on real properties. The tax on idle lands is intended to optimize land utilization and discourage land speculation. It is an additional levy of five percent (5%) on: 1) agricultural lands with an area of more than one hectare and one-half of the land remains; 2) Non-agricultural lands with an area of 1,000 sq. meters which remain unimproved; and 3) Unimproved residential lots in subdivisions.

The special levy on land may be imposed on lands benefited by public work projects that are financed by national or local governments. The levy should not exceed sixty percent of the actual costs of the project and should be apportioned among concerned landowners based on a formula to be established by the local legislative council.\(^7\)

A “capital gains” tax is imposed by the central government at six percent (6%) of the market or zonal value of the property. In addition, provincial and city governments can impose a tax on the transfer of real property ownership at one percent of the market value.

The idle land tax and the special levy remain largely unutilized. The definition of idle lands is structurally infirm since the average size of idle lands in urban areas is less than 1,00 sq. meters. The non-utilization of the special levy is mainly due to the lack of technical expertise of LGUs on its implementation.

\(^7\) There is an additional tax on real property in Metro Manila, at a rate of 0.25%, for the Flood Control and Drainage Fund (International Bureau for Fiscal Documentation, *Asia-Pacific Taxation*, Supplement No. 194, October 2000). [Note added by editors]