

THE NEEDS FOR CAPACITY BUILDING IN LOCAL GOVERNMENT IN MALAYSIA (WITH REGARDS TO PROPERTY TAXATION ADMINISTRATION)

By

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ABSTRACT

Property tax is a widely used fiscal tool because it is a vital source of income for urban authorities in developing countries like Malaysia. The tax, levied on land and buildings and is based on either improved or annual value. Valuation of these properties is a tedious and continuous process. In Malaysia, the revaluation exercise is still carried out manually. Due to financial, labour, and time constraints, most Local Governments in Malaysia are unable to meet this requirement and only capable to carry out revaluation every 10 years or more. Property taxation administration involves and requires good and skilled administrators, efficient system (property tax administration system) and advanced or efficient technology. University Teknologi Malaysia (UTM) has embarked on research and development of Computer Assisted Mass Appraisal (CAMA) for rating valuation to assist Department of Property Valuation in Local Governments to improve their capacity with regards to property taxation administration for the purpose of complying with the requirements of the Local Government Act 1976 which stipulated that every Local Government has to carry out revaluation every five (5) years. This paper discusses the capacity building in local governments in Malaysia and identifies areas in which they are lacking.

Keywords: computer assisted mass appraisal (CAMA), capacity building, property taxation, local government, property tax administration, technology

1.0 INTRODUCTION

Urban areas or cities are windows to society at large. They reflect the social structure and dynamics of the society. The increased population and urbanization triggers the local authorities to provide facilities such as public safety, health, administration, transportation and public utilities etc. They must be prepared for adjustments in meeting the challenges related to growing urbanisation.

Continued growth of urban areas are signs of a healthy economy. However, problems of degradation of urban goods and services such as a reduction in the quality of life, air and water, dilapidation of existing resources such as housing, clean air, water supply and road, still occur due to factors such as migration, land development and traffic congestion. The negative effect of these factors on the urban environment are known as negative externalities (Piquou, 1920) cited in Lai Yu (2000), and requires proper management. Consequently, to manage these negative externalities, we need not only additional investment (Glazebrook, 1992) but also an authority to act as the social co-ordinator (Lai Yu, 2000).

Such a transformation is already evident. Like local authorities in other countries, particularly those in advanced economies, the local government is also evolving itself to prepare for the challenges of the next millennium (UN SCAP). Most of their funds and employees were dedicated for providing services and facilities to the society. However, with the rapid expansion of urban areas brought about by economic prosperity, local authorities are increasingly involved in other activities such as planning and development of their urban areas and managing the effect of urban expansion.

A notable trend in many countries world wide is to embrace local government reform that is aimed at improving service delivery, economic efficiency and government accountability. To improve the financial base of the local government, most governments aim at making Local Government property taxation function optimally. It is because governments generally realise that property tax is a major source of urban revenue.

In Malaysia, this was the spirit of the reorganisation of local governments carried out in 1974. Amongst the objectives of the reorganisation as described by Norris (1980) are as follows:-

- (1) To develop a system of local government within which local authorities can adopt uniform laws and policies as well as carry out uniform functions and activities so facilitating central control;
- (2) To ensure effectiveness in the role of local authorities, in terms of local participation in local government affairs;
- (3) To ensure that local authorities become viable units and are able to function to the satisfaction of ratepayers;
- (4) To enable local authorities to participate actively in local development projects;

- (5) To turn local government units into competent authorities for town planning and development planning;
- (6) To ensure that administrative and developmental activities of local government organisations accord with the policies of the Federal and State government.

Like other parts of the public sector, local government has been transforming its services both to better meet the needs of local residents and businesses and also to deliver more efficiency gains. Exploiting the opportunities offered by new technologies is one way councils have been improving the delivery of many services whether at the customer interface or in the back office.

However, according to Phang (1989), Ahmad Atory Hussain (1991) and Hazman Shah Abdullah (1992), although the reorganisation exercise of local governments had improved their legal and organisational capabilities, some were still financially weak and too dependent on state and federal authorities. Why are some local governments still financially weak?

One of the reasons for this is inefficiency in the collection of rates (Phang, 1989 and Ahmad Atory Hussian, 1991). Other reasons include added responsibilities due to the reorganization of local authorities, limited sources of revenue local authorities could raise locally and the revaluation of properties for rating purposes are conducted at irregular interval (Phang, 1997).

Why the revaluation of properties for rating purposes is conducted at irregular interval? One main reason is because the valuation or revaluation process is conducted manually. The traditional or manual approach is the main cause of inefficiency in the local government's property tax administration capacity. To highlight the problems associated with this traditional approach, the next section will explain the property taxation and administration in Malaysia.

2.0 PROPERTY TAXATION IN MALAYSIA

Local governments in Malaysia are vested with the power to create their own revenue sources. The **Local Government Act 1976 (LGA 1976)** allocated the taxing powers among local government units (LGU) to collect property tax (rates). The power to impose the real property tax has been given to all local governments. The tax applies to all forms of real property such as land, buildings and other improvements. Exemption is given to real properties owned by government, charitable institutions and religious buildings. The tax is based on improved/market value (in State of Johor) or annual value (the rest of states) of the property. The tax rate varies from one local government to the others based on the targeted amount of collection set forth by each local authority. The amount targeted is set so as to meet their pre-determined annual financial budgets which comprises of the costs to provide public services, infrastructures, maintenance, landscapes, staff salaries, etc. Under the principle of fiscal autonomy, tax rates can vary

among different local government units (LGUs) as long as they are within the ceilings that are prescribed under the law. They are also imposed at differential rates according to the location of the properties either within or outside of the city center.

For example, the basic real property tax rate was set at 0.1% – 0.5% of improved/market value (1% - 10% of annual value) for residential properties, 0.15% to 0.5% of market value (5% - 10% of annual value) for commercial and industrial properties. Agricultural property is imposed at lower rates compared to residential, commercial and industrial properties. The rate is highly dependent on the targeted amount of tax to be collected and also on the market/annual value of the property. The higher the market/annual value, the lower the tax rate will be imposed. **Table 1** shows the rates for different type of properties imposed by local governments in Malaysia.

Table 1: The Property Tax Rate Imposed by Local Governments in Malaysia

Type of property	Annual Value	Improved Value (Market Value)
Residential	5% - 13%	0.15% - 0.35%
Commercial	6% - 13%	0.2% - 0.5%
Industrial	6% – 13%	0.25% - 0.75%
Agricultural / Vacant Land	2% - 7%	0.05% - 0.25%

The valuation of real property for taxation is mostly carried out by the local government assessors themselves or via privatisation. These properties are subject to revaluation every five (5) years as stipulated by the Local Government Act 1976 with the approval by the State Governments. The local assessor then prepares the assessment roll that contains a list of all properties in the LGU and their current market/annual 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.

Since revaluation of properties under the Local Government Act 1976 should be conducted every 5 years (even though in many circumstances, the revaluation is carried out after 10 – 20 years after the last revaluation), values are generally behind current values. Initial research found that there are inadequacies in tax administration such as lack of assessment tools and absence of technically qualified personnel. Valuation of the properties is carried out manually. All taxpayer's records are kept in files and sorted by account number. Retrieving records are slow and property tax administrators are having problems to analyse and manipulate the data into statistical or meaningful information for decision making process. There have been investments in tax maps and computerisation in most Local Governments, but these computers are not directly used for the administration of the property taxation except for tax collection.

The tax starts to accrue on the first of January every year. The property tax bills are issued every half-yearly (every January and July) but can be paid in one payment with some discounts given by certain local governments.

In most local governments in Malaysia, only the billings and the tax payments are computerised. Taxpayer's collection records are kept in computers. However, the computers are only used for tax collection purpose and not in the valuation process or in preparing the valuation roll. Only a few Local Authorities in Malaysia use the computer for valuation purposes but even that the valuation is done manually or through computation but one at a time and not using mass valuation/appraisal. Because the taxpayer's valuation records are kept manually, any enquiries on valuation calculation, appeal, become so difficult to entertain. So, most local authorities find it difficult to send letters of reminder to the delinquent taxpayers.

3.0 PROPERTY TAX ADMINISTRATION AND CAPACITY BUILDING

The reorganization did not do much in administrative of property taxation. Still the revaluation of properties is carried out after 10 – 20 years due to circumstances because property taxation requires efficient administration, effective taxation and valuation tool. There are inadequacies in tax administration such as lack of assessment tools, technical qualified personnel, and appropriate taxation techniques to value huge number of properties. Moreover the records are kept in paper files in cabinets and sorted under account numbers. Tax administrators are having difficulties retrieving, analysing, and manipulating the huge data. Investments in tax maps (GIS) and computerization in most local governments also does not help much, because this technology is mainly used for tax other purpose and not for valuation and administration process. The GIS itself even though is not new to local governments, but its development is slow and has not been fully exploited.

Due to difficulties of numerous properties, lack of time to carry out the revaluation, lack of man power and other constraints such as technology, strategic and financial led majority of the local authorities unable to perform efficiently to meet the spirit of reorganisation. This indicates the capacity gaps in taxation administration in local governments in Malaysia.

3.1 CAPACITY GAP

A Capacity Gap arises when a local authority does not have the capacity required for effective operation and maintenance of existing services. The Capacity Gap is defined as “the difference between the capacity required to operate and maintain services and the capacity available within the local authority. This includes the local government's organisational capacity, technical capacity, procedural capacity, and networking capacity as well as their financial resources”.

Figure 1 illustrates the capacity required to operate and maintain services tend to increase with level of service, the higher the levels of services, the greater the capacity required to effectively operate and maintain these services.

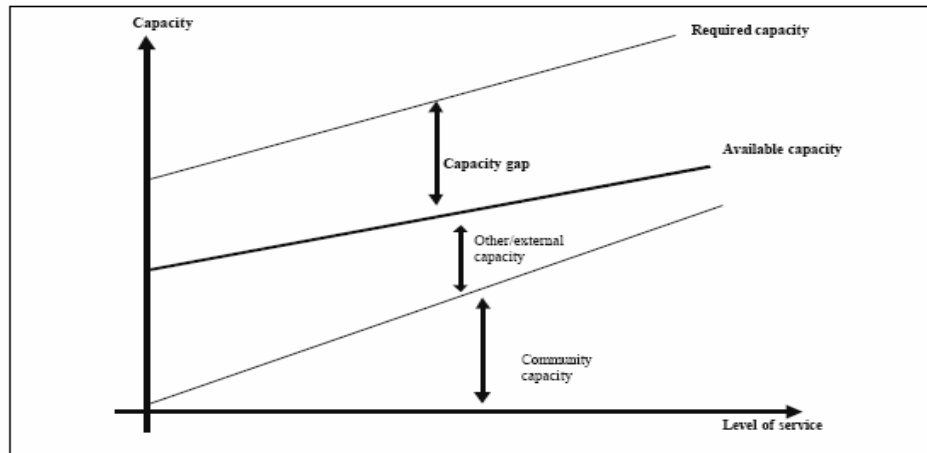


Figure 1: A Conceptual Illustration of the Capacity Gap

3.2 CAPACITY GAP ASSESSMENT AMONG LOCAL AUTHORITIES

The research significantly recognised the contextual factors of areas in which, the local authorities currently lacking the capacity and identifies the future gaps through the data collection. In future, this would lead most of the councils to determine the environment in which thinking about capacity to improve takes place.

Factors related to demand for improved capacity include:

- a) The time and resources required to implement multiple government initiatives;
- b) The size of authorities that affect economy of scale making it more difficult for smaller councils to implement initiatives such as e-government;
- c) The need of work in partnership; and
- d) Various stimuli for change such as inspection, valuation, working process and reports.
- e) Lack of skilled personnel, and
- f) Lack of advanced technology

Factors that affect the supply include:

- a) Recruitment and retention problems and turnovers;
- b) The impact of Comprehensive Performance Assessment (CPA) as poorly performing councils hunt for talent;
- c) Skills shortage in local labour market;
- d) Competitiveness in private sector and the pull of central agencies; and
- e) The attractiveness of the local government as an employer.

3.3 CAPACITY BUILDING FOR LOCAL GOVERNMENTS IN MALAYSIA

The World Customs Organization (WCO) defines capacity building as "activities which strengthen the knowledge, abilities, skills and behaviour of individuals and improve institutional structures and processes such that the organization can efficiently meet its mission and goals in a sustainable way." Capacity building is much more than training and includes the following (Carol and Fleming, 2001):

1. Human resource development, the process of equipping individuals with the understanding, skills and access to information, knowledge and training that enables them to perform effectively.
2. Organizational development, the elaboration of management structures, processes and procedures, not only within organizations but also the management of relationships between the different organizations and sectors (public, private and community).
3. Institutional and legal framework development, making legal and regulatory changes to enable organizations, institutions and agencies at all levels and in all sectors to enhance their capacities.
4. Function support development, describes the Information and Communication Technology implementation in processes to increase the productivity, technology adoption to manage data banks, strategic property and facilities management for implementation.

The research aimed to assist the administrative works in property taxation. Statement 2 and statement 3 are meant for organizational level. Statement 1 and statement 4 are relevant to the scope. Hence the capacity building under human resource development and Function support development are discussed as follows.

The human development and support function development can be classified into three sections for capacity building. Since the human development is more to work process training, technology is more to using software package for speed and storage. An interface is required to tailor the technology according to the work process requirement. So, the capacity building has three sections namely process, technology and integrated system. **Figure 2** illustrates how the work process and technology is integrated through interface.

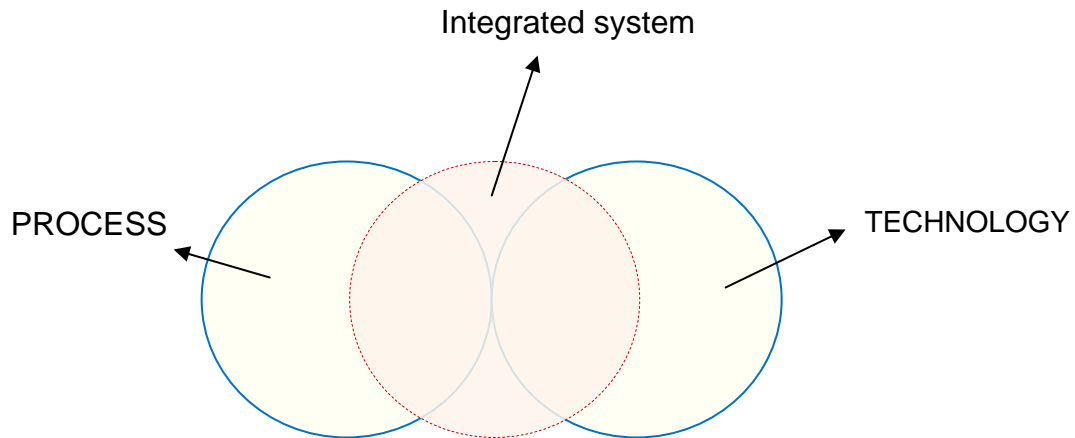


Figure 2. Technology & Process Integration

1. Process Training → Process training purpose is to strengthen the working process activities. Based the work functions, the following trainings are necessary as process training:
 - a) Valuation Methods used to value special properties (e.g. pipelines, railways etc.).
 - b) Administration of property tax.
 - c) Inspection of properties for new staffs.
 - d) Training on manipulating data into useful information for decision making process.

2. Technology Training → is necessary while collecting data and mapping the geographical details inside the databank. The necessary technology trainings are as follows:
 - a) AutoCAD for drawing building plans and maps.
 - b) GIS – to digitize the digital maps into computer.
 - c) Managing digital database.

3. Process and Technology Integrated System → as technology is a tool enable itself to tailor it according to the process, an integrated frame work will reduce the manual errors, processing time, reduced work load and also increase the accuracy, consistency, productivity. In this context, the technology integrated system is referred to the Computer Assisted Mass Appraisal System for property tax administration.

4.0 COMPUTER ASSISTED MASS APPRAISAL

The research awarded to a group of researchers in Department of Real Estate, Faculty of Geoinformation Science and Engineering, Universiti Teknologi Malaysia (UTM) in 1998 by Ministry of Science Technology and Innovation (MOSTI) is a flagship project to tackle the problems in administration of property taxation by the local governments in Malaysia. The aim of this research (entitled “The Development of Computer Assisted Mass Appraisal – CAMA for Local Authorities in Malaysia”) is to help

the local government valuers and administrators to manage the property taxation in general and in the process of valuation or revaluation exercise in particular.

During the implementation of this project in three (3) local authorities namely Segamat (with 47,000 properties in 2001-2004), previous revaluation 1981), Kuantan (80,000 properties in 2004-2006), previous valuation 1996) and Maran (7,000 properties in 2006-2007), previous valuation 1995), we found that there are capacity gaps among the administrators and the assessors within the local government property taxation administration. There are cases where large properties are undervalued which caused accumulated losses of revenues to local governments amounting to million of dollars. Subsequently, this research would recommend the capacity building development framework in pre-identified areas to improve the capacity of local government to manage property tax efficiently.

As an initial towards capacity building, the research developed an integrated environment for the taxation administrators to integrate ICT, process and technology through computer assisted mass appraisal (CAMA) system.

The term computer assisted refers to the calculation necessary to value property by automated computer systems. The term of mass appraisal is defined by the International Association of Assessing Officers as “..the valuation of many properties as of a given date.” (Eckert, 1990). Overall, CAMA is an automated computer assisted appraisal system which allows mass calculation in a stipulated time with high degree of accuracy. In contrast, the conventional manual assessment is very time consuming and low degree of accuracy.

With the help of CAMA system, the local government can obtain a fair and efficient tax assessment system. The advantages of CAMA system are as follows:

- Less manpower and time consumption
- More accuracy
- Quality assurance
- Cost effective
- Data management system
- Fair valuation and revaluation
- Good sales and administrative system

This CAMA system is user friendly and needs less time to master, its computational competence includes performing complex and voluminous calculation which could be quickly undertaken by computer compared to the manual system. It has been proved that the CAMA system is widely used all over the world. CAMA is very efficient in all aspects including valuation and revaluation, data analysis, data selection and keeping the data base. With the use of CAMA system, the quantity of man power can be reduced and the appraisal can devote more time to collect necessary information to value the property.

4.2 CAMA IN MALAYSIA

The computer assisted mass appraisal is still new to Malaysia. The mass appraisal is automated with integrating GIS together with enormous statistical data bank. The research used two types of data for its data bank namely first, digital topography and lot map in DXF format of the town area is necessary for GIS. The map data were classified into feature layers such as roads, borders and cadastre lots. Secondly, the site inspection datasheet of a set of properties of each area for evidence and statistical analysis.

The development of Computer Assisted Mass Appraisal integrated with GIS (CAMA-GIS) system paves a smooth way to handle the huge data bank, appropriate techniques for mass appraisal and automation in property taxation. As the name suggests (mass appraisal), the research formulates a consistent framework and developed the appropriate procedures according to the Local Authorities norms and constraints. The enormous data storage, statistical package and quantitative technique analysis, digital topography and lot map in DXF mapped with GIS are all integrated in CAMA-GIS framework.

The CAMA-GIS is implemented at three different state local authorities in Malaysia namely Segamat in the State of Johor, Maran and Kuantan in the State of Pahang. The tested system results are reliable, accurate, equitable and defensible. The interface of CAMA-GIS screen shots are shown in Appendix 1. The system is proven viable to implement to other local governments in Malaysia since the costs of revaluation as conducted in the above three (3) municipalities did not exceed the normal cost if the projects are privatized to private firms which will be conducted manually. These 3 revaluation projects is viable with the help of UTM using locally developed CAMA-GIS system.

5.0 CONCLUSION

The transition from manual approach to computerized property tax administration has long been waited by property tax assessors and administrators in local authorities in Malaysia. There were attempts by a few local governments to use imported CAMA Systems but were failed due to its inability to customize to local environment and requirements. The CAMA System developed by UTM has proven successful in three local government units in Malaysia and it should be suitable to other LGU's as well.

Developed countries like United States, Australia, New Zealand, Sweden has successfully applied the CAMA System 10 – 30 years ago. It's time for Malaysia to use CAMA in Property Taxation administration efficiently since Government of Malaysia have invested millions of dollars in ICT but it has not been fully utilised at local governments level.

The transition from manual to computerised requires a good capacity development programmes suitable for local environment and requirements. The immediate capacity development required by local government in Malaysia should include process training, technology training and process and technology integrated system training to overcome the major problems why the revaluation of properties cannot be carried every 5 years as stipulated by LGA 1976.

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