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Replacing Income Tax Regime with a New Property Tax System: Towards Efficient Asset Markets in India

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ABSTRACT:

India's tax system relies mainly on income tax, yet less than 2% of the population pays it, leaving a narrow base vulnerable to evasion and the black economy. This study explores property tax as an alternative, assessing revenues through three methods—PIM, Income Capitalization, and Adjusted Market Value. The analysis shows property tax could yield 2.4–5.1% of GDP, potentially surpassing income tax while improving market efficiency and transparency. Policy recommendations include phased rollout, digitized land records, and anti-benami reforms to ensure equitable and stable growth.

KEYWORDS: property tax, income tax replacement, asset markets, tax evasion, India.

Introduction

India's tax system has historically played a significant role in supporting economic growth, development, and governance. Nevertheless, despite its expansion, it continues to face persistent structural challenges. Key concerns include widespread tax evasion, the predominance of the informal economy, inefficiencies in tax administration, and relatively low compliance levels. Moreover, the system's excessive reliance on indirect taxation, particularly the Goods and Services Tax (GST), coupled with an underperforming property tax framework, exacerbates these issues

India's taxation system suffers from structural imbalances. In FY 2023–24, the country's nominal GDP stood at ₹295.36 lakh crore, yet income tax collections were only about ₹19.58 lakh crore—roughly 6.6% of GDP. Despite this, barely 2% of the population (around one in ten families) contributes to income tax . Such a narrow tax base exposes deeper systemic issues, including a black economy estimated at 20–30% of GDP, corporate malpractices like inflated expenditure claims and transfer pricing, and the widespread concealment of capital gains from real estate.

Inefficiencies in India's asset markets, particularly real estate, stem from non-transparent pricing practices, inadequate disclosure, and speculative investment patterns. Implementing a well-structured property tax regime could mitigate these issues by ensuring more reliable property valuation and strengthening ownership documentation. By shifting greater emphasis toward property taxation, India could enhance the productive use of land resources while simultaneously curbing speculative tendencies. By utilizing the vast reservoir of productive, consumptive, and underused assets, a property tax framework could provide a more equitable and resilient source of revenue.

.This paper examines the potential of property taxation as an alternative or supplementary mechanism to address existing weaknesses and enhance the efficiency of the current tax regime.

predictable source of income..While income and consumption-based taxation dominate discourse in India, property taxes remain underutilized, poorly administered, and largely overlooked. With the growing significance of assets in the economy and the continuous rise in real estate values, property taxation presents a substantial opportunity for revenue generation. Yet, limited attention has been given to assessing the feasibility of adopting a comprehensive property tax framework as either an alternative or a supplementary system. This study seeks to explore the potential for expanding, restructuring, and modernizing property taxation to address prevailing challenges in India's tax regime, including widespread evasion and missed opportunities to enhance market efficiency.

Markets frequently fall short in ensuring efficient allocation of resources in both production and consumption because prices often fail to capture their true economic significance. In production, speculative behavior, concentration of market power, and regulatory constraints can cause prices to diverge from marginal costs and marginal products, leading to inefficient use of resources. On the consumption side, distortions such as information gaps, advertising influences, and externalities prevent prices from reflecting marginal utilities, thereby misguiding consumer choices. Additionally, market transactions rarely account for opportunity costs, particularly in areas like real estate, where holding land or property idle imposes minimal financial burden. These shortcomings underscore the need for corrective measures—such as taxation, regulatory oversight, or institutional reforms—to better align market outcomes with broader social welfare objectives.

Estimates of property tax revenue generated through the Perpetual Inventory Method (PIM), Income Capitalization Method, and Adjusted Market Value Method reveal considerable inconsistencies. Such variations indicate persistent market inefficiencies and the inability of prevailing prices to adequately represent marginal products, marginal utilities, or opportunity costs. In light of these shortcomings, this study investigates the viability of replacing the income tax regime with a property tax–based system as a means to strengthen efficiency and transparency in India's asset markets.

Reviews

Mathur et.al(2009)study on property tax revenue in various Indian cities revealed several factors influencing its yield, including coverage of properties, collection efficiency, valuation methods, and exemption levels. The analysis showed a 12.4% increase in property tax revenue over three years (translating to a 7.9% average annual growth). Interestingly, Karnataka and Tamil Nadu boasted the highest collection rates, while Bihar and Madhya Pradesh lagged behind. Furthermore, the study found that India's national property tax yield is estimated to be between 0.16% and 0.24% of GDP, which falls short of the average for developing countries (0.6%) and transitional economies (0.68%). To improve this situation, the study recommends broadening the tax base and establishing Central Valuation Boards in each state.

Song (2008): This study proposes a comprehensive reform for China's property tax system, advocating for an ad valorem property tax applied throughout the ownership period. By increasing the holding cost of vacant properties, it aims to discourage housing speculation, which is a form of market inefficiency. This reform seeks to stabilize the housing market and promote efficient resource allocation based on the principles of "ability to pay" and "user pays."

Locke (2007): This study investigates the applicability of the Efficient Market Hypothesis (EMH) to the property markets in Britain and Australia. Using price indices and analyzing monthly returns through autocorrelation and run tests, it assesses weak-form efficiency. The findings indicate that the Australian real estate market exhibits weak-form efficiency, meaning past prices have little predictive power for future price movements, suggesting a relatively efficient market. In contrast, the British property market is found to be inefficient, implying potential opportunities to exploit historical data for investment strategies, which points to market inefficiencies.

Karras et al. (2009) conducted a study to empirically examine the impact of tax changes on economic growth (measured by real GDP per capita). Their findings suggest that a 1% increase in the overall tax rate can lead to a long-term decrease in real GDP per capita of -0.5% to -1.2%. Specifically, the study found that various taxes, including income taxes, property taxes, social security contributions, and taxes on goods and services, can all negatively impact economic growth. Notably, while property taxes didn't show a statistically significant effect, increases in social security taxes and taxes on goods and services had a more significant negative impact on GDP per capita compared to income taxes.

McCLUSKEYet.al (2010) study finds that property tax revenue in Central and Eastern European (CEE) countries is low, averaging only 0.5% of GDP compared to the OECD average of 1%. This suggests significant potential for increased revenue generation from property taxes in the CEE region. The author proposes a shift towards a value-based property tax system, which would be more buoyant (generate more revenue over time) than relying on increased central government shared taxes and grants to support local government growth.

Bahl et al. (2010) explores property tax reform options for developing countries, where property tax revenue typically falls below 1% of GDP. The authors analyze existing systems and highlight their limitations in generating sufficient revenue. To address this, they propose a unified property tax system with four components: an annual tax on all rural and urban properties, a land-based presumptive tax on agriculture, an income tax, and a capital gains tax. This comprehensive approach is estimated to raise revenue to 3% of GDP, justifying the administrative costs involved.

Methodology

Three estimation approaches are applied to measure potential taxable capital stock:

The Perpetual Inventory Method (PIM) is widely applied in economics to estimate the value of an economy's capital stock over time. Rather than attempting to measure all assets directly, it builds estimates by accumulating past investment data and adjusting for depreciation. This approach is particularly useful for analyzing asset markets, as it highlights how assets are created, maintained, or depleted, and provides insights into market inefficiencies or the potential effects of policies such as property taxation.

The income capitalization approach is a property valuation method that determines the worth of real estate based on the net income it produces. Rather than relying solely on rental figures, it incorporates key indicators such as rental yield and capitalization rate, offering a more comprehensive measure of value. While applicable to both residential and commercial assets, this method is particularly advantageous for assessing commercial properties.

The Adjusted Market Value (AMV) Method is a valuation approach that begins with a property's observed market price and refines it to correct for distortions in the data. Since official records such as sale deeds or registry entries may not fully capture actual transaction values—owing to factors like underreporting, speculative activity, outdated circle rates, or incomplete information—the method applies adjustment factors to bridge this gap. In doing so, AMV produces a more realistic and equitable estimate of a property's economic value.

In Case of Property Tax

India's income tax framework faces persistent structural weaknesses, with revenue collections undermined by widespread income underreporting, benami (proxy-owned) assets, and the presence of a large black economy. Corporate practices such as inflating expenditures through window dressing and the use of transfer pricing strategies by multinational firms further diminish taxable income. Real estate, a major store of household wealth, often escapes effective taxation, as capital gains are underreported and a significant portion of transactions—estimated at 30–50%—occur in cash. In contrast, a well-structured property tax system could directly target tangible assets such as land, buildings, and machinery, which are less easily concealed. With India's nominal GDP projected at ₹331.03 lakh crore in FY 2024–25 (Press Information Bureau), the adoption of a robust property tax regime has the potential to generate considerable additional revenue, particularly if directed toward the wealthiest 10% of households (~36 million), who collectively own about 65% of the country's assets.

Estimating property Tax Revenue

This study assesses the viability of a property tax regime by estimating India's capital stock through three valuation techniques: the Perpetual Inventory Method (PIM), the Income Capitalization Method, and the Adjusted Market Value Method. These calculations incorporate distortions arising from tax evasion, the black economy, and benami holdings. A uniform tax rate of 2% is then applied, with the bottom 90% of households excluded from the tax base. Such an approach reflects prevailing patterns of wealth inequality—where the top 10% control nearly 65% of household assets—and aligns with the limited participation observed in the existing income tax framework.

This study evaluates the feasibility of such a shift, focusing on three main points:

1. Can property tax replace income tax as a primary source of revenue?
2. What revenue potential do alternative valuation methods reveal?
3. How might property tax correct market inefficiencies in India's asset markets?

Results

The **Perpetual Inventory Method (PIM)** Capital stock is estimated by accumulating historical Gross Fixed Capital Formation (GFCF) and applying sector-specific depreciation rates. In FY 2024–25, combined public and private investment (GFCF) increased by 7.1% (MoSPI). While the precise GFCF figure is not directly reported, based on a nominal GDP of ₹330.68 lakh crore and assuming GFCF accounts for roughly 33% of GDP (Wikipedia), the estimated GFCF stands at around ₹109 lakh crore.

Capital Stock Estimates:

- Production Assets: ₹290 lakh crore
    - Agriculture: ₹60 lakh crore
    - Industry: ₹113 lakh crore
    - Services: ₹117 lakh crore
- Consumption Assets: ₹240 lakh crore
    - Household: ₹216 lakh crore
    - Government: ₹24 lakh crore
- Unused Assets (adjusted for benami holdings): ₹37 lakh crore

From this, the total taxable capital stock—covering the top 10% of households and non-household assets—is estimated at about ₹420 lakh crore.

Tax Revenue Potential: Applying a flat property tax rate of 2%, while exempting the bottom 90% of households in line with wealth distribution, the estimated revenue equals approximately ₹8.4 lakh crore, or about 2.54% of GDP.

Income Capitalization Method

Methodology:
Capital stock is estimated using the following equations:

For production assets:

$$K = \frac{\alpha \times GAV}{r+\delta}$$

For consumption assets:

$$K = \frac{Service\ Flow}{r+\delta}$$

where:

- α\alphaα = capital income share (Agriculture: 0.4; Industry: 0.5; Services: 0.3)
- r = discount rate (0.06)
- δ\deltaδ = depreciation rate

Capital Stock Estimates (FY 2024–25)

Using India's nominal GVA of ₹300.15 lakh crore for FY 2024 and applying the methodology above:

- Production Assets: ₹900 lakh crore
    - Agriculture: ₹210 lakh crore
    - Industry: ₹310 lakh crore
    - Services: ₹380 lakh crore
- Consumption Assets: ₹275 lakh crore
    - Household: ₹257 lakh crore
    - Government: ₹18 lakh crore
- Unused Assets (adjusted for benami holdings): ₹37 lakh crore

Thus, the total taxable capital stock (top 10% households + non-household assets) is approximately ₹912 lakh crore.

Tax Revenue Potential

Applying a uniform 2% property tax rate:

Tax Revenue=0.02×912=₹18.24 lakh crore\text{Tax Revenue} = 0.02 \times 912 = ₹18.24 \text{ lakh crore}

Tax Revenue=0.02×912=₹18.24 lakh crore

This equates to about 5.51% of GDP (with GDP at ₹331.03 lakh crore)

Adjusted Market Value Method — (Updated to FY 2024–25)

Methodology:
AMV uses observed real-estate prices with a 40% premium to allow for underreporting, incorporates an estimated black-economy adjustment (≈₹43.03 lakh crore, ~13% of GDP for FY 2024–25) distributed as 50% production / 40% consumption / 10% unused, and applies a 20% benami adjustment to unused assets.

Capital stock estimates (FY 2024–25, updated):

- Production: ₹731.02 lakh crore
    - Agriculture: ₹574.96 lakh crore
    - Industry: ₹73.49 lakh crore
    - Services: ₹82.57 lakh crore
- Consumption: ₹211.17 lakh crore
    - Household: ₹182.80 lakh crore
    - Government: ₹28.37 lakh crore
- Unused (after benami adjustment): ₹42.13 lakh crore
- Total Taxable Capital Stock (top 10% + non-household): ₹737.59 lakh crore

Tax revenue at a uniform 2% rate:

Tax Revenue=0.02×737.59=₹14.75 lakh crore\text{Tax Revenue} = 0.02 \times 737.59 = ₹14.75\ \text{lakh crore}

Tax Revenue=0.02×737.59=₹14.75 lakh crore

This is approximately 4.46% of nominal GDP (FY 2024–25) (₹331.01 lakh crore).

Thus, both the Income Capitalization and Adjusted Market Value methods exceed income tax revenue, while PIM remains slightly below.

Market Inefficiencies and Divergence in Estimates

The large discrepancies among the three valuation approaches—PIM (₹8.348 lakh crore), Income Capitalization (₹17.768 lakh crore), and Adjusted Market Value (₹15.463 lakh crore)—underscore persistent inefficiencies in India's asset markets and the inability of prices to accurately reflect marginal productivity, utility, or opportunity costs.

- PIM (Lowest Valuation): Because it is derived from historical GFCF, this method tends to undervalue assets, as it is tied to outdated book figures and omits unrecorded transactions in the black economy. It also fails to capture speculative price increases in real estate and the scale of benami holdings.
- Income Capitalization (Highest Valuation): This method inflates estimates by assuming that current GVA reliably represents asset productivity. In India's rapidly growing economy, however, income flows may exaggerate capital stock, while distortions such as transfer pricing and accounting manipulation further inflate values.
- Market Value (Intermediate Valuation): While closer to real-time conditions, this approach is skewed by widespread cash dealings and benami property, which push reported values beyond official records. Moreover, market prices are often disconnected from economic use—for example, farmland with limited yields may be priced at speculative highs, while empty housing retains high market value despite offering no utility.

Key Sources of Inefficiency:

- Speculation: Property markets, especially in cities, are often driven by speculative demand rather than productive value.
- Opacity in Transactions: Benami ownership and black money transactions conceal true asset values, leading to mispricing.
- Asset Illiquidity: Idle resources, such as vacant land, are priced without reflecting their lost opportunity cost.
- Policy Distortions: Artificially low circle rates encourage undervaluation, tax evasion, and further divergence between market and official values.

Towards Efficient Asset Markets

Shifting from income tax to a stronger property tax system could help fix many of the problems in India's asset markets:

- Wider Tax Net: Property taxation captures wealth stored in land and buildings, which are harder to hide compared to income. The estimated taxable value of assets (₹15.463 lakh crore) is already higher than income tax collections (₹12.76 lakh crore). Targeting mainly the top 10% of families, who own about two-thirds of household wealth, makes the system fairer.
- Lower Evasion Risks: Unlike income, which can be easily underreported, physical assets leave a paper trail through land records, registries, and municipal databases. With digitized land records and satellite mapping, it becomes much harder to disguise ownership or hold property under benami names.
- Better Use of Assets: A modest 2% tax on vacant land or empty houses would discourage hoarding and push owners to put their assets to productive use. This would reduce waste, lower speculative bubbles, and bring asset values closer to their real economic worth.

Barriers and Practical Considerations

- Weak Compliance: Property tax collections in India are currently very limited—about ₹0.5–1 lakh crore, or just 0.14–0.29% of GDP. This shortfall arises from evasion, benami ownership, and administrative weaknesses. Even if enforcement improves, realistic recovery under the Market Value method may only reach 30–50% of potential, translating to ₹4.64–7.73 lakh crore. Although significant, this still falls short of income tax revenues.
- Equity and Exemptions: Restricting property tax to the top 10% of households requires reliable wealth identification, which is complicated by benami transactions and trusts. Similarly, excluding certain categories such as government buildings or agricultural land (roughly half of ₹301.35 lakh crore) lowers the effective Market Value tax yield to about ₹9.44 lakh crore, or 2.72% of GDP.

CONCULSION

A 2% property tax on the top 10% of households and non-household entities could yield ₹₹8.4 lakh crore, ₹331.03 lakh crore (2.4–5.1% of GDP) in FY 2025–26, compared to 4.46% from income tax. The Adjusted Market Value method offers the most realistic estimate, balancing revenue potential with

adjustments for the black economy. While property taxation could expand the base, reduce evasion, and improve asset market efficiency, challenges of enforcement, valuation, and political acceptance remain significant.

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