

*Remarks on "A Bad Bunch: Asset Value Under-Reporting in the Mumbai Real Estate Market"*

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# Research Question

- ▶ Great, policy-relevant research question: to what degree do individuals underreport the sales price of their property to reduce transaction tax liability in India?
  - ▶ Two great innovations relative to previous research: they observe both reported and true market prices (with some noise) and they develop a bunching methodology that allows them to exploit this noisy information in true prices to recover the degree of underreporting.
  - ▶ They are the first to think about transaction taxes in a developing country (and also in a country that uses guidance values as part of their transaction tax).

# Institutional Structure

- ▶ 5% transaction tax remitted by the buyer. The tax owed is the maximum of government guidance values ( $c$ ) and the reported market value ( $m$ ) given by the buyer.
  - ▶ This is different than in the US context where transaction taxes are exclusively a function of the sales price.
  - ▶ If a buyer wishes to underreport  $m$ , we expect what will typically happen is that the buyer and seller agree on a lower official price and then make a cash side-payment to cover the difference. This lower official price is then reported as  $m$  to the government.
  - ▶ So the basic question in this paper is to what degree do transactions underreport  $m$ ? Or relatedly, to what degree do transactions bunch at  $c$ ?

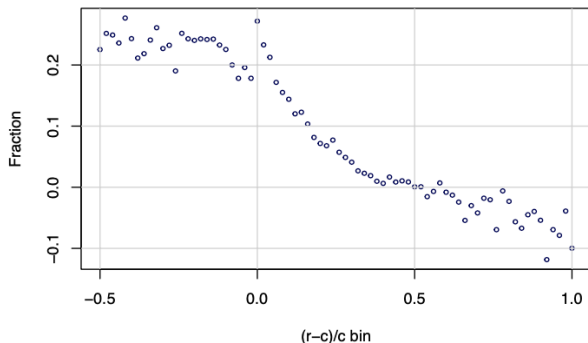
# Institutional Structure

- ▶ The choice to underreport the official sales price is also a function of:
  1. Other taxes, including the property tax (small), capital gains tax (individuals) and corporate income tax (developers).
    - ▶ The “corner solution” behavior at  $c$  suggests that the results are largely driven by the transaction (or property) tax, though all may contribute to the attractiveness of bunching at  $c$ .
  2. Mortgages - unlikely to obtain a mortgage for more than the official price
    - ▶ They find evidence that when the loan-to-value ratio is high, bunching at the guidance value is lower.

# Summary of Findings

- ▶ The baseline estimates find that the average household is underreporting by about 13%. Elasticities of the reported value to the transaction tax rate range from 1.3 to 8, with the largest at homes with the lowest government guidance values.
  - ▶ The authors note that the underreporting rates are smaller and the elasticities are larger than other contexts like self-employed earnings in Pakistan (Kleven & Waseem, 2013) and others.
  - ▶ Perhaps more natural to compare the results here to the price manipulation found papers studying housing transaction taxes (Best & Kleven, 2015; Kopczuk & Monroe, 2015; Slemrod, Weber & Shan, 2017).
- ▶ They have some nice evidence that what they observe is, in fact, consistent with underreporting (e.g what happens when guidance values change, etc).

# Underreporting

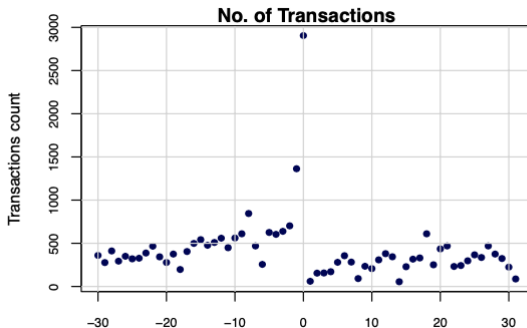


- ▶ Underreporting falls off dramatically above  $c$ , suggesting that it is, in fact, roughly a corner solution.
- ▶ And with demonetization, fewer are able to reach this corner solution, so bunching declines.

# Underreporting

- ▶ This raises the question - for everyone that is not underreporting, are they unable or unwilling to cheat? Some of it's clearly related to inability - mortgage constraints, need for cash, being a developer.
- ▶ Does distance to  $c$  matter? - plot the fraction bunching (or amount underreporting) by  $(p-c)/c$  bins.

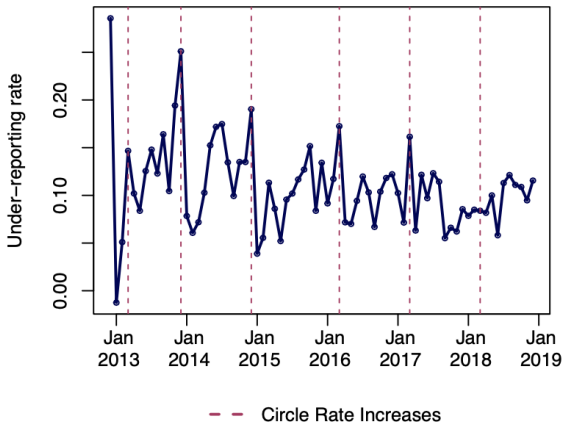
# Timing Elasticity



- ▶ Seems to be a substantial timing elasticity. What is the typical change in  $c$ ? What fraction of this is driven by backdating? How easy is it to retime or backdate?
- ▶ Another test: bunching at the new  $c$  across the change.



# Underreporting Decline over Time



- ▶ Why is underreporting declining over time? Has the relationship between  $p$  &  $c$  changed over time? Has it become harder to backdate?

# What is the Optimal Policy?

- ▶ There are the following policy options besides what India currently has:
  1. India could tax only based on the reported price - this would presumably increase underreporting. Seems suboptimal.
  2. India could tax only based on the assessed price - they would never collect tax revenue above the guidance value, but they would eliminate the use of black money. You could calculate roughly how much tax revenue they would lose and calculate a number for how much India would need to be willing to pay to eliminate side payments to make this switch optimal.