

CHAPTER III

C

THE THIRD GENERIC PECULIARITY OF LAND

THE SELLING VALUE OF LAND AN UNTAXED VALUE

EVERY LANDOWNER IS EXEMPT FROM TAXATION ON HIS INVESTMENT, TO THE EXTENT OF THE TAX TO WHICH HIS LAND WAS SUBJECT AT TIME OF HIS PURCHASE, AND THEREFORE, PRACTICALLY SPEAKING, NEARLY ALL LAND IS TO-DAY OWNED FREE OF ANY TAX BURDEN

The purpose of the following illustration* is to make clear by means of iteration and reiteration two facts, viz.:

Fact I. The land owner† of to-day who has purchased since the present tax was imposed escapes taxation upon his investment.

Fact II. The burden of a land tax cannot be made to survive a change of ownership.

*The statements and arguments used in this illustration deal only with the general principles of taxation, and assume such conditions as prevail in the United States, including for instance, lack of universality and uniformity in taxation. Single tax terms and arguments are studiously excluded.

† Care is taken to designate owner and user in their respective capacities, whether they be two persons, or two combined in one.

The illustration is intended to show the effect in a normal or advancing community of mortgage interest and taxes upon the market value and cost to the user of a lot of land and a house respectively having equal purchase and rental value, and each subject to the same mortgage interest and taxes.

FIRST: THE LAND

Proposition 1.—Let it be supposed that you want a piece of urban land that is worth \$300 a year to you for use. You can afford to pay \$300 a year and no more, and it can be had at an annual cost of \$300 a year.

Let us then proceed to acquire this piece of land, exercising diligence and caution to profit by each step in the transaction.

(a) At the very outset the question arises, what is the thing for which you are proposing to pay \$300? Surely it is not the soil itself, because it is a question of a building site, which could be had out in the country for little or nothing. It is not merely the area upon which to dig a hole in the ground, wall it about, and erect a building, for the same space can be had elsewhere for a song. In short, it is not the earth's surface; it is not the inherent capabilities of the soil; it is not light and air, or other bounties of nature resident in that lot of land; it is not natural resources of which you are thinking as worth to you \$300 a year.

(b) But what you are going to pay for is the accompanying and incidental use of a great many expensive things outside of the piece of land, things which you will need and must have, which you cannot afford to

provide at your own expense, but for the use of which you can afford to pay in proportion as you use them. It is these outside things, available by their proximity, for which you are called upon to pay \$300 a year. To enumerate some of them specifically, they are, in a town or city lot, right and ease of access to water, health inspection, sewerage, fire protection, police, schools, libraries, museums, parks, play-grounds, steam and electric railway service, gas and electric lighting, telegraph and telephone service, subways, ferries, churches, public schools, private schools, colleges, universities, public buildings — utilities which depend for their efficiency and economy on the character of the government; which collectively constitute the economic and social advantages of the land; and which are due to the presence and activity of population, and are inseparable therefrom, including the benefit of proximity to and command of facilities for commerce and communication with the world — an artificial value created primarily through public expenditure of taxes. In practice, the term "land" is erroneously made to include destructible elements which require constant replenishment; but these form no part of this economic advantage of situation or site value.

(c) In other words, you are to pay \$300 a year for the value of what the law calls the "rights and privileges thereto pertaining," specified in every deed of land conveyance. This \$300 is ground rent, "what the land is worth for use."

Proposition 2.— Assuming this piece of land to be free from all charges and incumbrances, and assuming the current rate of interest to be 5 per cent per annum,

you would purchase the lot for \$6,000, because interest upon that sum would amount to the stipulated \$300 a year. But if, on the contrary, the lot bears a mortgage of \$2,000, upon which the annual interest charge is \$100, then the lot will cost you \$4,000.

(a) The mortgage interest charge of \$100 reduces the selling price of the land by the amount of the mortgage, \$2,000, and you will buy the land, not at \$6,000, but at \$4,000, the value of the equity remaining after mortgage interest has been paid.

(b) By purchasing title you will assume the mortgage and will pay the mortgage interest, \$100, but that \$100 will not come out of your \$200, the net income from your investment of \$4,000; it will come out of the gross income, the ground rent, \$300. It is a part of, and not an addition to, the ground rent. You will pay the interest, but you will not bear it, because you will have bought yourself clear of the burden.

(c) The lot will thus cost you annually for use, interest on your purchase price (\$4,000 at 5 per cent) \$200, plus mortgage interest (\$2,000 at 5 per cent) \$100, equal in all to \$300, all that the land is worth for use, use being the only relation of land to man with which economics has reasonable concern.

Proposition 3. — But, besides being subject to a mortgage of \$2,000, assume further that this lot of land is subject also to an old tax of \$100, which charge the purchaser must also assume. You will then purchase the land not at \$4,000, but at \$2,000.*

(a) As already seen, the mortgage interest charge of

* By the term "old tax" is intended the tax in force at time of last purchase; by "new tax" one imposed since last change of ownership.

\$100 reduces the selling price of the land by the amount of the mortgage, \$2,000. It is equally true that the tax charge of \$100 reduces it by the same amount, \$2,000; the mortgage and the tax together therefore reduce it by \$4,000; and you will buy the land at \$2,000, the value of the equity which remains after both mortgage interest and tax have been paid. This \$2,000 is the capitalisation of the annual value of the lot to you after all charges have been met.

(b) In purchasing you will assume both mortgage interest and tax and will pay them, but you will pay them out of the gross income of \$300, and not out of the net income of \$100 from your investment of \$2,000. Therefore no part of the \$2,000 which you pay for the equity will be taken from you in taxation, either as principal or interest.

(c) The lot of land will thus cost you for use: interest on your purchase price (\$2,000 at 5 per cent), \$100; plus mortgage interest (\$2,000 at 5 per cent), \$100; plus taxes, \$100; and these together aggregate \$300, what the land is worth for use, the same as before.

(d) It follows then that, under the present system, assuming free competition, the selling value of land is an untaxed value,* and land owners who invest to-day are exempt from taxation — not indeed upon their land, but upon its annual net or income value to them, or, in other words, upon their investment. The gross value is the taxed value. The net value is an untaxed value.

(e) As this exemption of the present owner holds

* Assessors make use of the selling value of land as the basis for their levy because it is more easily ascertainable than the gross value, but in reality and effect the levy is upon the gross value, which, if land were not taxed at all, would be also the selling value.

true to-day, so it will be true in future of each new purchaser subsequently to the imposition of any new tax. It is in the very nature of things that the burden of a land tax cannot be made to survive a change of ownership.

(f) This is equally true of a bond, but it is assumed that a tax levy should be not upon intangible stocks and bonds legally conceived as property, but only upon tangible goods and estates. It is, to be sure, just as true that a man who builds a house to rent pays no tax on his investment, but for a different reason. The tax, in that case, is shifted upon the user in increased house rent, except so far as, by discouraging building, it is reflected in lower wages for building. But an old tax upon the land is a burden neither upon present owner nor user. The tax on land is "absorbed," that on the house is "shifted."*

(g) We cannot too soon or too rigidly fix in mind the fact that this ground rent of \$300 is the governing factor in the situation; that it is a tax laid not by the State but by nature, which every man must pay for the use of land, either to a private owner as rent, or to the State as a tax, or to both. No statute or ordinance can increase or reduce, exempt from, or abolish the payment of this "economic rent," or ground rent, to somebody. Its amount is neither fixed nor affected by the tax that is put upon it, whether large or small. Taxing it cannot increase it; cannot decrease it; cannot abolish it. Its amount may always be calculated by this simple formula: ground rent equals interest

* Landlords who own and let both land and tenement houses, apartment houses, and business blocks thereon, escape the burden of the tax on their land, and at the same time shift upon their tenants the building tax, thus avoiding all share in the tax burden.

on purchase price, plus interest on any mortgage, plus taxes.

Proposition 4. — Neither a tax upon ground rent, nor the ground rent itself, adds anything to the cost of land for use.

(a) Economic rent, ground rent, measures the value of all public, quasi-public, and social service. If the whole ground rent is not a burden, but merely an equivalent for social values received, neither can interest and taxes, two of the parts of which ground rent in our illustration is composed, be a burden upon the user. A tax upon rent comes out of rent, which, as has been explained, is the natural tax that every user has to pay to some one, and hence it subtracts nothing from wages and adds nothing to the cost of living.

Proposition 5. — You cannot pay \$6,000 for the land and in addition pay either the mortgage interest of \$100 or the tax of \$100, because that would make land cost you \$400 per annum which by our assumption is worth only \$300.

(a) The tax upon land cannot be added to the ground rent — which is kept at its maximum by market demand — but is a part of, and must come out of, ground rent. If it could be added, that fact would itself indicate that the ground rent was \$400 instead of \$300, which is contrary to supposition. Land worth only \$300 a year cannot be made worth \$400 a year by putting a tax of \$100 upon it.

(b) Let it not be forgotten that ground rent, in the sense in which the word is used, is the same homogeneous thing, one and indivisible, the world over — what land is worth for use. It is rent — or use value — not cost of construction or cost of production —

that fixes the price of land. Economic rent is the initial and governing factor from which all calculations must proceed.

SECOND: THE HOUSE

Proposition 6. — *The lot having been acquired, let it be supposed that you are in need of a house, and that such a house as you want would cost to build \$6,000, or, in interest, \$300 a year, the same as the annual cost of the land.*

(a) You will observe at once that the problem of the house is quite different from that of the land. The cost of acquiring land depends primarily upon its rent. Conversely, the rent of a house depends primarily upon its cost. Builders will not build houses unless they can get interest on the cost of construction. Competition among builders will not allow one builder normally to get more than interest on cost of construction.

Proposition 7.— *If such a house were free of tax, but mortgaged for \$2,000, it would cost you to buy only \$4,000, and it would cost you to use, as in case of the land, interest on purchase price (4,000 at 5 per cent) \$200, plus interest on mortgage (\$2,000 at 5 per cent) \$100, making \$300 as before.*

(a) The mortgage upon a house, like that upon land, will add nothing to the cost of the house for use.

Proposition 8 — *But you find that such a house is subject also to a tax of \$100, which you will have to pay in addition to the above \$300, interest on purchase and mortgage, making the house cost you for use altogether \$400, instead of \$300 a year, or \$100 more on account of the tax.*

(a) Unlike the tax upon land, the tax of \$100 upon the house cannot come out of the \$300 rent (house rent or interest) except indirectly through its effect upon wages as before mentioned, because house rent cannot normally be less than interest on the actual cost of building the house; it must instead be paid by the user of the house, over and above his interest, making his house rent, the annual cost of his house for use, \$400 instead of \$300.

(b) To repeat: a house rent, otherwise \$300, is increased to \$400 by a tax of \$100 on the house. In contrast with this, you may either take off a present tax of \$100 from the land, or you may increase that tax to \$200, and in neither case will the cost of the land to the user be affected. Take off the \$100 tax from the house, and the cost of the house to the user will be reduced from \$400 to \$300 a year; of land and house together, from \$700 to \$600.

Proposition 9.—The moral of this illustration is that you get for use annually \$300 worth of land for \$300, and a house costing \$300 for \$400. In other words, a tax upon land is a part of, is included in, and comes out of, ground rent, and is no burden to the user: while a tax upon a house is a clear addition to house rent, and comes principally out of the user of the house.

To recapitulate: (1) It has been shown that a house tax of \$100 that has been regularly levied takes in taxation \$100 a year of the user's income.

(2) It has been shown that a land tax of \$100 takes in taxation no part of the income of the user or present owner, provided that he purchased the land after the tax was imposed.

The beauty of this illustration is that (in a classification which excludes duplication by certificates or mere legal evidences of property, like stocks, bonds, etc., and includes only actual tangible property) while land stands as always for everything except the products of labour, a house is here made to stand as the representative of any and all products of individual labour, that is, for everything except land, and the illustration thus becomes all inclusive.

If you have had the patience to follow it understandingly you may rest assured that you have mastered a basic principle of taxation, and have solved one of the most perplexing problems of political economy.

What the Authorities Say of This Third Generic Peculiarity of Land, viz., That Its Selling Value Is an Untaxed Value.

"The land tax, which is next on the list, should equally cause but little controversy. It is persistently claimed as a burden upon land, or land owners; but this will not bear scrutiny when we inquire out of whose income the tax is paid, or what way it causes pressure, so that its reduction or abolition would be a benefit to the community.

"As a fixed charge upon land for generations, it is now past all controversy a rent-charge. In many instances it has long since been redeemed, the property having subsequently changed hands; in others, inheritors of property have acquired it under the burden, and have calculated their income minus the tax, while purchasers, in buying, invariably allow for it. To reduce" (abolish?) "it now would be to present the landowners of England with a capital sum of nearly £30,000,000. Their estates, relieved of the burden, would become at once so much more valuable, and if they did not sell, they would pocket an additional income which they never inherited or paid for."—*Sir Robert Giffen, "Essays in Finance," First Series, p. 242.*

"But whatever may be thought of the legitimacy of making the State a sharer in all future increase of rent from natural causes, the existing land tax (which in this country [England] unfortunately is very small) ought not to be regarded as a tax, but as a rent-charge in favour of the public; a portion of the rent, reserved from the beginning by the State, which has never belonged to or formed part of the income of the landlords, and should not, therefore, be counted to them as part of their taxation, so as to exempt them from their fair share of every other tax. As well might the title be regarded as a tax on the landlords; as well, in Bengal, where the State, though entitled to the whole rent of the land, gave away one-tenth of it to individuals, retaining the other nine-tenths, might those nine-tenths be considered as an unequal and unjust tax on the grantees of the tenth. That a person owns part of the rent does not make the rest of it his just right, injuriously withheld from him. The landlords originally held their estates subject to feudal burdens, for which the present land tax is an exceedingly small equivalent, and for their relief from which they should have been required to pay a much higher price. All who have bought land since the tax existed have bought it subject to the tax. There is not the smallest pretence for looking upon it as a payment exacted from the existing race of landlords.

"These observations are applicable to a land tax only in so far as it is a peculiar tax and not when it is merely a mode of levying from the landlords the equivalent of what is taken from other classes. In France, for example, there are peculiar taxes on other kinds of property and income (the *mobilier* and the *patente*), and supposing the land tax to be not more than equivalent to these, there would be no ground for contending that the State had reserved to itself a rent-charge on the land. But wherever and in so far as income derived from land is prescriptively subject to a deduction for public purposes, beyond the rate of taxation levied on other incomes, the surplus is not properly taxation, but a share of the property in the soil, reserved by the State. In this country there are no peculiar taxes on other

classes, corresponding to, or intended to countervail, the land-tax. The whole of it, therefore, is not taxation but a rent-charge, and is as if the State had retained, not a portion of the rent, but a portion of the land. It is no more a burden on the landlord, than the share of one joint tenant is a burden on the other. The landlords are entitled to no compensation for it, nor have they any claim to its being allowed for, as part of their taxes. Its continuance on the existing footing is no infringement of the principle of equal taxation."—*Mill, "Principles of Political Economy," Volume II., Book V., Chapter II., Section 6.*

"A more difficult and disputable point arises in connection with the incidence of a long continued land tax. Here it is said that the tax is really a deduction from property. As land is sought for its revenue, what lowers its revenue lowers its selling price, and therefore a land tax falls altogether on the possessor at the time of its imposition. Subsequent acquirers take the land subject to the burden, and pay a lower price in consequence. This process of "amortisation," as it has been called, makes the subsequent removal of the tax undesirable; the persons who have lost by its establishment are not the same as those who gain by its remission. A purchaser has got land cheaper, and gains a further advantage by escaping the tax; in fact he is allowed for it twice over, once at the time of purchase and again at that of remission.

"The element of truth in this theory, which has received much favour, appears to be the following: (1) as previously pointed out, when a land tax becomes definitely fixed so that it can be foreseen, or even capitalised and redeemed, there is no inaccuracy in speaking of it as a charge on land, which lowers its selling price; it is just the same as a mortgage, and is so regarded by purchasers."—*Bastable, "Public Finance" (1903), page 440*

"If a certain tax is levied and it is expected that it will continue to be levied indefinitely in the future, it will reduce the selling

value of the land by the amount of the capitalised value of the tax. The future owner will, therefore, be able to buy it so much cheaper that he will realise as large a percentage on his investment as though the tax had never been levied."—*Thomas N. Carver, Yale Review, Nov. 1896.*

A recent College and University text book* makes reference to the argument of this illustration, as re-stated in Chapter XII., in the following comment:

Many present-day followers of Henry George find in this principle of amortisation at once a justification and a method of securing for society all economic rent. Under present conditions, they say, a man who buys land wholly escapes taxation upon it. Consequently, in order to make landowners pay as much as other people we should have to increase the tax upon land by a rate equal to that paid by the average tax payer as often — say every thirty years — as the land of the community changes holders. In this way the State could gradually and with justice absorb all economic rent.

But this whole chain of reasoning is fallacious for three reasons:

(a) This capitalisation takes place only to the extent that the tax on land is exclusive and unequal, and modern taxes upon land are not of this nature.

(b) In so far as this programme of the single taxers were anticipated and understood, it would visit the whole burden of the "reform" upon present owners, instead of being distributed over several generations. Subsequent purchasers would discount these periodic increases of the tax and pay to owners for their land only the present value of the rapidly vanishing income from land. Land would be valued simply as a terminable annuity.

* "Outlines of Economics," Revised Edition, by Richard T. Ely. The Macmillan Company, 1908, pp. 621, 622.

(c) This whole doctrine overlooks the inevitable consequence that, if "the selling value of land is an untaxed value" and "if the burden of a land tax cannot be made to survive a change of ownership," these facts would so increase the demand for land that the profits from its purchase and ownership would not exceed profits in other lines of investment."

Let us examine these points one by one.

(a) It is, as I understand, admitted by all economists that in the United States (the country now under consideration) the tax on land is everywhere exceedingly unequal, and, especially in the large cities, almost exclusive.

Either the capitalisation of the land tax is a fact or it is not. If it is a fact it is, with its corollaries, the most vital fact of all those bearing upon the material welfare of the race, and ought not to be brushed aside in three short unsupported sentences like the above, all of which are substantially contrary to the mass of evidence assembled in these chapters.

But the capitalisation of the land tax in the United States is a settled fact, and hence not debatable; a business condition of every-day knowledge in the buying and selling and assessment of land. It is out of the domain of theory, and not dependent upon any abstract speculation concerning an exclusive and unequal tax.

For the sake of illustration: First. Let it be assumed that there are two, and only two, fields open to investment, viz., land paying 5 per cent on purchase price and bonds paying 5 per cent on purchase price (because either by exemption or by evasion they escape taxation). What is it that fixes the above rate

of 5 per cent prevailing to-day in both cases? Is it not supply and demand? When there is a surplus of capital, rates are depressed; when a scarcity of capital, rates are advanced. The question is, What and how has taxation to do with this 5 per cent rate of interest?

Again: Let it be assumed that a way has been found to exact from all bonds a tax of \$25 per thousand, or one-half the income. Inviting investment, there would then be, land paying 5 per cent, bonds paying 2½ per cent, and what would happen? If the interest rate is 5 per cent owners of bonds will continue to hold them for an income of 2½ per cent or they will sell at approximately half price, but as loans are renewed borrowers will have to pay the market rate of interest, what capital is worth for use, plus the tax. The rate of interest will still be fixed, as now, by supply and demand, and not by taxation. What has taxation to do with the general interest rate more than with the gross ground rent of land? The idea that if a uniform rate of tax were imposed and collected from all incomes it would lower the rate of interest is admitted to be highly speculative and seems to find contradiction in every money market. As to the statement that modern taxes upon land are not virtually exclusive and unequal, how can this possibly be true when the alleged bane of the present system is that more than three-quarters of personal property escapes taxation?

(b) The proposed plan of "some of the present-day followers of Henry George" is set forth in the same text book in the main correctly, and admirably, as above, except that their specific recommendation is limited to absorbing only enough economic rent to meet all public expenses, an object which might be accom-

plished gradually and almost imperceptibly in one generation. *The execution of this particular plan would involve an increase in the rate year by year sufficient to take in taxation annually an additional 1 per cent only of the gross ground rent for thirty years, or one generation. An average of about 20 per cent of gross ground rent is now taken in taxation, as for instance in Boston. If an additional 1 per cent should be taken each year for thirty years, it would amount finally to 30 per cent, which, added to the 20 per cent already taken, would make 50 per cent, or one-half, which is about the average proportion that present taxes bear to ground rent.*

By this plan, at the end of thirty years the burden of \$15 (1½ per cent) per thousand *on present valuation*, now borne by the occupier, will have been placed on the land holder, and this transfer of burden would, even if land did not meantime increase in value, reduce the selling value of his land, every \$1,000 to \$700. Meantime, few land owners would suspect the change, much less be prejudiced by it.

But if a thirty-year bond is at a premium, and worth one hundred and fifteen dollars to-day, and will be worth only one hundred dollars or par at maturity, does the whole burden of the vanishing fifteen dollars premium fall upon the "present owners"? The new million dollar office building will probably be worth little or nothing in three generations, but this whole burden of ninety years natural decay is not visited upon "present owners." The immediate reduction of 1 per cent (or one point on the stock board) in value of land would not greatly depress selling value, while increased taxes and consequent deprecia-

tion of ten, twenty, or thirty years hence are very slightly discounted to-day.

Therefore, the assertion that the above programme "would visit the whole burden of the reform upon present owners" is erroneous and confusing, especially when the burden of a three hundred dollar thirty years' depreciation is offset by an appreciation of perhaps more than \$1,500 (as is the case in Boston) which offset is rightfully a part of the economic situation. Many laws, tariff laws among others, do not pretend to insure against sporadic cases of possible injustice but the universal law remains that, with civilisation, the value of land increases.

(c) The statement of the book on this point comes far short of covering the actual condition. The facts that the "selling value of land is an untaxed value" and that "the burden of a land tax cannot be made to survive a change of ownership" have indeed so increased the demand for Boston land that in value probably more than three-quarters of it is to-day in dead hands or in the hands of trustees and syndicates which cannot die, all of whom refuse to loosen their grip upon this "preferred stock" except at exorbitant speculative prices which would yield income far under other lines of investment.