

Twenty-one Land Value Taxation Questions and Answers

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LAND VALUE TAXATION, sometimes called site value taxation, is being carefully examined by economists and state and local government opinion makers as an alternative to the *ad valorem* property tax. In what follows, I have asked and answered basic and sometimes embarrassing questions concerning a property tax limited to the site value of land.

Question Number One: Why is the exemption of personal property and structures and a tax on land only better than the present system?

1. It avoids the very serious problem of setting the depreciated value of industrial buildings and equipment.
2. It reduces very sharply the job of assessment.
3. It takes the burden of the property tax off value created by individual effort and places it on value created by society.

Question Number Two: Is it right to tax one kind of capital value (land) and not other types?

This has already taken place. It was done when intangibles, certain types of personal property and special properties, were taken off the tax rolls or taxed at lower rates. It also exists in different excise tax rates on different products and in lower income tax rates on capital gains and the exemption of interest on municipal securities from the federal income tax.

The taxation of the capital value of structures without taxing the capital value of jewelry, stocks and bonds, deposits, insurance and all personal property places a heavier tax burden on the necessity, housing, and on buildings required for retailing and manufacturing than on other assets. On the other hand, the taxation of land acts to decrease the cost of land needed and used by the amount of the capitalized value of the land tax and stimulates the demand for land by encouraging new construction.

Therefore, a land only property tax does not increase the cost of the necessity, land, because land, unlike other capital, does not have a cost of production while the removal of the capital value tax on buildings and personal property stimulates economic development. The price of land is a result of the productivity of society arising from the application of brains and brawn. Land rent and land prices together only perform the function of *rationing* a scarce resource and not that of meeting costs of

production as is the case of the price of a man-produced good or services.

Question Number Three: Doesn't the land tax increase the costs of farming and increase the tax burden of farmers?

No, it decreases the cost of buying land and other capital used in farming and increases the ability of workers to buy farm and forest products. The land tax on agriculture and forest land holds down rising land prices and reduces the income and sales taxes that have to be paid by owners of land and the other consumers of farm and forest products. It also reduces the costs of owning farm equipment, inventories and structures, for these would no longer be taxed.

Question Number Four: How have programs of special aid for agriculture and the cities affected land prices?

All government programs which extend direct assistance to particular areas raise land prices. Therefore, much of the intended benefit in lower prices or higher earnings are incorporated into gains for landowners. High prices for farm land have eaten up most of the higher income from farm operations that agricultural price support payments were supposed to provide.

Question Number Five: Why is the exemption of structures and a higher tax on land better than the way it is being done now?

The answer here is that in addition to the answer to Question No. 1, it emphasizes the good effect a land tax has on the economic use of land. Land owners cannot afford to let land stand idle and pay a substantial tax. The result is that those unable or unwilling to use land fully will sell it to those able and willing to make full use of it. Land becomes more productive while tending to fall in price, for the increase in the use of each unit of land is the equivalent of increasing the quantity of land. Holding land for ransom no longer pays and everyone is better off because of it.

Question Number Six: How can you say "everyone is better off" when an aged person of moderate means is unable to hold onto his land?

Any move toward land taxation would include provision to permit exceptions during the lifetimes of the aged, the blind, and so on. This is being done today under the "circuit breaker," the idea popularized by the Advisory Commission on Intergovernmental Relations of Washington, D.C. (ACIR) and its research director, John Shannon. The idea finds expression in a set of procedures for reducing the property tax on homes and the property tax "pass-through" on rented houses and apartments when the burden becomes too large in relation to the income of

the taxpayer. For example, in Oregon a new law permits the deduction of property taxes from the state personal income tax liability when the property tax on the house or apartment reaches a certain percentage of income. (Interestingly, a sort of negative income tax provision awards a payment to the taxpayer when the income tax is not high enough to accommodate the property tax!) When any of these procedures for preventing property taxes from becoming regressive are employed, the people benefited are better off. Those who have a large home, for example, which they may no longer need but which they love, would be able to retain it because the house, no matter how valuable, would be tax exempt.

Question Number Seven: This may be true in the long run, but in the short run wouldn't ranching and forestry be hurt by using only a land tax and not a property tax covering structures and some personal property?

No, because the amount of taxes to be collected need not be increased. The active, progressive farmer and forester would benefit. The inactive landowners and land speculators would be prodded to make better use of land they control. The use of land tax only would also facilitate the collection of higher amounts in lieu of taxes on federally owned land.

Question Number Eight: How would a land tax that replaces existing property taxes work in the cities?

It is the only urban tax that uses a base that can't leave town. The land tax encourages economic use of land space in the city. Business firms and income earners are not induced to leave town as they are when urban sales or income taxes are increased. Instead, under a land tax business and personal investments within the city limits are encouraged. This works to reduce urban sprawl and to increase the efficiency of the city as an economic unit.

Question Number Nine: Won't the land tax eliminate city open spaces?

Yes and No. Yes, it will cut back sharply on vacant lots and incompletely used land throughout the metropolitan area. No, but open spaces will be publicly-owned and subject to careful planning and use. The city will include more developed parks and fewer asphalt parking lots and most of the rubbish-filled vacant lots will be eliminated.

Question Number Ten: Isn't it unfair to metropolitan area landowners to pick on urban land to provide a large portion of municipal revenues?

The value of land within the urban area, *i.e.*, the capitalized value of current and expected income, is likely to be sustained and not to decrease

despite the higher tax rate applied to land values. The total to be collected from property taxes is not being increased. The only change taking place is that the collections based on the value of improvements and structures is being eliminated and only the value of the land is included in the tax base.

The new construction stimulated by the change to a land tax, *i.e.*, site value taxation, acts to increase the demand for urban land. The result is maintenance of urban land prices despite the higher tax rate on land values. Also, because it becomes profitable to replace old buildings with new buildings when buildings are not included in the tax base, old neighborhoods regain economic viability. Also, one must not forget that across the country land has been increasing in price more rapidly than the wholesale commodity price index, and that as the members of the postwar baby boom acquire family living quarters, urban area landowners will be enjoying windfall profits.

The taxation of urban land and the exemption of structures reduces the demand for land surrounding the urban area. The more compact city resulting from fully using the city's land resources reduces the demand for outlying land for residential, commercial, and industrial uses. The result is the increase of the availability of these areas for recreation and agriculture—a greenbelt, if you will, through use of land value only in the property tax base.

Question Number Eleven: What is unearned increment and how is it related to land taxation?

It is the difference in the value of land today from what it would be if its value represented only what past and present owners had done to improve it. It is the value arising from all the government and private activities making the land reachable, livable, and richly salable, and from artificial scarcity produced by withholding land from its best use waiting for society to increase the value.

It is the amount of capital value that can be taken through land value taxes and, therefore, through the reduction of net income from the ownership of land without decreasing private efforts in the development of land and without diminishing the desire of the individual to own land privately.

The land tax rates that would be needed if the current property tax collections were raised entirely from the land value base are far less than the level which would be required to pick up all unearned increment.

Question Number Twelve: Is a land tax a progressive or a regressive tax?

It is a progressive tax because it is a tax on wealth, and wealth is more unequally distributed than taxable income. Also, those able to withhold land waiting for higher prices are generally high income receivers. A study in Wilwaukee, Wisconsin, showed that the top 10 per cent of the income receivers would pay 53 per cent of the land tax. Large corporations are also large owners of land and it is the higher income people that are the large stock owners. Also, land is often purchased by high income individuals to be combined with some agriculture and stock breeding to reduce federal and state income tax payments. In agriculture 2.3 per cent of the farms account for 43 per cent of the acreage.

There is no possible way to pass a land tax forward in higher prices. Because land taxes do not increase land costs to builders of new facilities, they cannot be passed on to renters and consumers as can taxes on structures or sales or corporate profits. This situation relative to land taxes arises because land does not have a cost of production. Also, the quantity of land does not materially increase or decrease with a change in price. On the other hand, investment decreases with tax-caused lower profits, and production is reduced when tax-caused higher prices reduce sales and force marginal producers to discontinue operations.

Question Number Thirteen: Isn't the taxation of land a disproved doctrine of Henry George and the single tax movement?

Yes, Henry George believed in taxing land rents. A position he adopted from the writings of David Ricardo, who, along with Adam Smith, established the science of the economics of private enterprise. In Australia, New Zealand, and South Africa, property taxation is largely limited to a land tax which works very well indeed. The idea has also been partially applied in Pittsburgh, an area in Michigan and Alabama and also in Canada.

New conditions related to urban problems and unequal distribution of the ownership of land, and the California Supreme Court decision (holding that public school financing cannot equitably be limited by the lack of taxable property values in the poorer school districts) have combined to make a uniform state land tax a very attractive revenue source to finance basic education.

Question Number Fourteen: If land only is taxed under the property tax, what is to be done about the taxation of public utilities?

There are two basic approaches to this problem. One is to enact a state value-added or gross receipts tax on the value of services to pick up

the reduction in tax collections. The other is to require the utilities to reduce their rates by the amount of the tax reduction. Either approach eliminates the ability of districts where utilities are located to force the users of the service to subsidize those who happen to live where large utility properties are located. In any case, the adoption of a land tax only property tax eliminates once and for all the horrendous job of attempting to place a value on utility production and distribution facilities.

Question Number Fifteen: Why do property tax studies demonstrate that many assessors under the present property tax tend to put a very low value on land and particularly on land held in large parcels?

This practice arises from three basic causes. These are:

- 1) A tendency to confuse the property tax with the income tax and therefore to grossly under-value under-used land not bringing in enough net revenue to pay the full tax on its market value.
- 2) Because of assessor training and tradition they emphasize the value of improvements. As a result, a predisposition to use a rather elaborate set of procedures to place an excessive value on structures. This calculated structure value is deducted from sales prices of similar properties (land and structure) to arrive at a residual which is the value allocated to the land.
- 3) Land holdings, particularly large parcels, are frequently concentrated in the hands of politically powerful individuals who are able to influence valuations downward. This is much easier to do without attracting attention when properties other than land provide a very large portion of the total property tax base.

Question Number Sixteen: What do we know about how property tax payments would be redistributed if the base consisted of land only?

The detailed Milwaukee, Wisconsin, study showed that in a large city:

- 1) Idle land, parking lots, gas stations, slums, and other decaying, obsolescent or ill-advised buildings that add little or nothing to the value of vacant land would pay in total about 50 per cent more.
- 2) No change would occur in tax payments where the ratio of improvement to land is close to the city average of two to one.
- 3) A decrease of 40 to 75 per cent would be effected in taxes paid on good homes, apartments, office buildings and commercial and industrial structures where improvement value runs four times or so the land value.

In Oregon, we learned that an average residential property consisting of a \$20,000 house and a \$5,000 lot would experience property tax pay-

ment reductions of about 25 per cent if land only were included in a property tax base to which a high enough rate was applied to provide collections at current levels. Vacant urban and suburban land plus underutilized industrial and commercial properties, including railroads, would experience about a 50 per cent tax increase. Total property taxes on typical commercial and industrial properties would be unchanged and electric and telephone utility properties would have their total property taxes reduced by 50 to 75 per cent. Studies in California approximate this. Because of low property tax rates in some rural and industrial areas, a 2 per cent statewide land tax to finance primary education, as an example, would substantially increase property tax contributions of these groups to the financing of this portion of education. However, the tax rate on improvements and other taxable property would be reduced. The amount of the reduction would depend on the funding relief arising from state finance of primary education.

Question Number Seventeen: Aren't these shifts too great for society to bear except in a serious crisis?

The shifts are really much less than the 50 or 25 per cent figures tend to indicate. This is true because the reduction of earnings from land ownership arising from higher land taxes does not reduce the amount of land. Also, because the property tax of households tends to decline under a land tax, the shift tends to reduce the cost of living of families. In addition, the payment of higher taxes by land speculators and under-users of land would be helpful for it would stimulate economic activity in the construction industry and reduce economic pressures for urban sprawl and the absorption of good farm land for unproductive urban use.

Nevertheless in this tax area, the change would be best accomplished in a previously-established series of steps that might cover a period as long as five years. This is a procedure well established in modifying tax legislation. The use of this approach here would bring about the necessary adjustment with an annual price and income shift less than has been experienced through price changes due to changing economic conditions during the 1966-71 period. It is also true that having the change cover a number of years will give assessors an opportunity to bring many land assessments up closer to highest and best use values.

Also, I believe the crisis is serious and requires a vigorous program. We must stop the growing urban inefficiency and the increasing inequity arising from failing to use uniform statewide tax rates to finance elementary and secondary education. Also, court decisions are saying the procedure now used is unconstitutional.

Question Number Eighteen: Just what approach to a land tax do you recommend?

I recommend state legislation giving counties and home rule cities the option as to whether all property other than land be eliminated from the tax rolls. They would, of course, be able to place high enough rates on land to provide revenues equal to that allowed under the constitution for the old type of property tax.

Next, I recommend a statewide uniform land tax high enough to meet all the costs of primary education. (If adopted, a low constitutional limit on local property tax rates would be appropriate.) A statewide uniform land tax of about 2 per cent would finance 100 per cent of the costs of Kindergarten through sixth grade schooling. However, because land is currently badly assessed and greatly undervalued, the land-only approach can be expected to cause assessed land values to rise, permitting a lower tax rate to meet primary education financial support needs. This improvement can be easily realized through use of a map and applying standard unit values regardless of parcel size. (K-through-6 schooling is my definition of basic education.)

Question Number Nineteen: Any other legislation needed?

Yes. Congress and state legislatures need to pass legislation permitting families to deduct from taxable income the charges for services such as sewerage, garbage collection, street lighting, street cleaning, police patrolling and fire protection. This would put local government service charges on the same basis as exists for the payment of property taxes. One cannot deny that this type of legislation is long overdue. Its adoption would be very helpful to local governments in meeting their fiscal problems.

Congressional and legislative action here would help to move away from financing community services now largely provided by local governments from collections of a tax based largely on capital value of improvements. The use of service charges on the basis of cost of services is a much more workable approach to the financing of these activities.

Question Number Twenty: What is the next step?

The Advisory Commission on Intergovernmental Relations should draft model legislation providing for:

- 1) a local option land only property tax;
- 2) a 2 per cent state land tax to be used to cover the costs of all education, Kindergarten through sixth grade; and
- 3) the deductibility of service charges of local governments from the taxable income of households.