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Taxation of Land Values

BEING CHAPTER VII OF THE
FIFTH BIENNIAL REPORT

OF THE

Minnesota Tax Commission

1916
ST. PAUL, MINNESOTA

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CHAPTER VII

THE TAXATION OF LAND VALUES

Recently at a meeting of the All-Minnesota Development Association, an organization having for its purpose the promotion of the development of the natural resources of the state and the betterment of the social and economic conditions of the people, a resolution was adopted favoring a reduction of tax burdens on personal property, and on buildings and improvements on land. The discussion that preceded the adoption of the resolution brought out the fact that a number of those in attendance at the meeting were single taxers, while others favored a modified form of the Henry George theory of taxation. The latter would use land as the base of all taxes, to be supplemented, perhaps, by specific taxes on business and income.

The Exemption of Personal Property

Minnesota is one of the few states that still persists in taxing all forms of personal property. Many of the other progressive states of the Union have abolished such taxes in whole or in part and have substituted other more equitable revenue measures. Scarcely any other nation outside of the United States, and certainly no advanced nation, now imposes a tax that corresponds to our personal property tax. We pride ourselves on the progressive spirit of the American people, and yet many of the older countries of Europe, as well as some of the Australian colonies and Canadian provinces, have far outstripped us in tax reform. They have shown a much greater readiness than we have to change their tax systems when change seemed desirable, and to adopt new methods better suited to the changing social and economic conditions of modern civilization. Perhaps we are less progressive than we think we are, especially in matters of tax reform. Nevertheless the future is not without hope, for a growing public interest in matters of general taxation is discernible everywhere, and particularly in our own state. An intelligent public interest is a prerequisite of tax reform.

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The movement for the total or partial exemption of personal property from taxation is not a new one in this state. For many years past a considerable number of our people, though by no means a majority, have favored either the modification or total abolition of personal property taxes. This sentiment is due in part to the feeling that our attempts to tax property of this character have not been successful from the viewpoint of either completeness or equality. This is particularly true of the many elusive forms of so-called intangible personalty, the volume and value of which has grown so rapidly with us during the past quarter of a century. Then, too, there has been a growing feeling that the tools and implements of production—farm tools and stock used in agricultural pursuits, and the tools, implements and machinery of the manufacturer—should not be taxed; that if personal property taxes are to be imposed at all they should be imposed on production rather than on the instruments of production.

Still stronger opposition is developing to the tax on household goods. Such property produces no income; its value to others than the owner is a doubtful quantity. If homes are to be maintained, and homes are the backbone of a state, we must have chairs and tables and cook stoves and beds, yet in this state we tax these essential things of the home. More illogical still is the tax on the clothes we wear, not even the modest shirt and overalls of the workman being exempt. It is small wonder that there is a growing sentiment against such taxes.

The growing opposition to personal property taxes is reflected by the increasing number of bills introduced in each succeeding session of the legislature for repeal or modification of taxes on personalty. This is particularly true in so far as it relates to taxes on intangible personal property.

The original tax provision of the state constitution, adopted in 1857, required taxes to be equal and uniform on all classes of property, regardless of character or use. This restrictive provision was an effective bar to tax reform up to 1906, when an amendment was adopted changing the uniform rule on all classes of property to uniform on the same class of subjects. This amendment permitted the classification of property for purposes of taxation.

The first step in classification, following the adoption of the amendment, was taken in 1907, when a law was enacted providing for a low registration tax on mortgages in lieu of all other

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taxes, followed by a specific tax on grain in 1909, and by the three-mill tax on money and credits in 1911.

A still more radical step in classification was taken in 1913 by the enactment of a law dividing property into four classes for purposes of taxation, and providing for the assessment of each of the different classes at varying percentages of true and full value. The law is fully discussed in another chapter of this report. It is sufficient here to say that while the classification was perhaps based on expediency rather than on sound economic reasoning, the law recognizes the logic of the advocates of the exemption of household goods by placing such property in the lowest class. It also makes some concession to the tools and implements of industry as compared with some other forms of property. By placing iron ore in the highest class some slight recognition is given to the "state heritage" theory, and also to the contention of not a few of our people that the mineral deposits of the state, being the gift of nature, should bear a heavier tax burden than the products of labor.

That the classification law could be improved is generally conceded; nevertheless, it is regarded as a step in advance by those who would exempt personal property from taxation. Until the exemption provision of the state constitution is enlarged it would not be possible to bring about complete exemption of such property. The power to classify, however, is sufficiently broad to permit of a low tax on certain classes of property that many of our people think should be entirely exempted. To this extent at least the law commends itself to those who would entirely eliminate all personal property taxes.

That the personal property tax will eventually be abolished in this state is altogether probable. Apart from the question of its economic soundness, it has other objectionable features. It is a difficult tax to equitably enforce, hence often unjust in application. In a measure it puts a penalty on honesty and a premium on dishonesty, especially when applied to certain forms of personal property. No state should persist in a tax that makes evasion and dishonesty profitable. Many of the most progressive states in the Union have already abandoned it in whole or in part. It has never been successfully administered in any state. In its present form it can never be successfully administered in this state.

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The Exemption of Buildings and Improvements

The resolution first referred to also favors a reduction of tax burdens on buildings and improvements on land. The principle of entire exemption of such property from any form of taxation has numerous supporters in this state, although the resolution apparently only favors the placing of a lower tax on buildings than on the land itself. In a measure, total exemption of improvements is a modified form of the single tax theory, but quite distinct from it.

Briefly explained, the advocates of the **single tax** propose to abolish all taxes save those upon land values. They contend that the value that attaches to land because of the growth of population and the development of industry belongs to the people, and consequently should be taken for the use of the people. They hold that there are two distinct kinds of value, one the result of individual effort, which in equity belongs to the individual; the other, the result of the presence, needs, and activities of the whole community, and in justice ought to be devoted to the public use, because created by the public.

It is claimed that every community has an indefeasible original right to the land on which it exists, and to all the natural, unmodified values and advantages attached thereto; that every individual in the community has **an equal** right to the land, while all the individuals together have a **joint** right to the income which these natural advantages command. This income is known as land value or economic rent.

Land value, or economic rent, is defined as the largest annual amount voluntarily offered for the exclusive use of a given area of land in its natural state—without buildings, and undrained, unfenced, unfertilized, unplanted and unoccupied. It is proposed to socialize economic rents—to appropriate them to the public use —and from the proceeds thereof to defray all expenses of government, federal, state and local. The plan in its fullest sense contemplates the total elimination of import and internal revenue taxes, as well as property taxes, whether general or specific.

The Unearned Increment Tax

Another considerable school advocates appropriating to the public use a part of the **future** unearned increment of land. They oppose the taking of **past** increment as unjust to the present owner

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because of vested rights. In effect, the single tax denies the validity of vested rights, while the principle of taxing future unearned increment recognizes the validity of such rights. The former would tax the economic value of the land in the form of an annual rent without regard to present ownership, while the latter would appropriate to the public use some part of the future increase in the capital value of land. In computing the future increase in the capital value of land, it is conceded that the added value arising from labor or improvements on land should not be regarded as unearned increment.

While the unearned increment tax has been quite widely discussed for more than a generation past, so far it has not been adopted in any section of the United States.

Increasing public expenditures in recent years, particularly in cities, have made necessary the devising of new sources of revenue, and the increment tax has been urged as a feasible and equitable method of meeting this growing demand on public purse. It is held that the rapid growth in land values in most American cities, due to increasing population, is a community growth, and that part of the increase should be used to meet growing public expenditures. Recently the committee on taxation of the city of New York reported in favor of an annual increment tax of one per cent upon the future increase of land values in that city as shown each succeeding year by comparison with the assessed value at the time the law was enacted.

It was contended by a majority of the committee that the increment tax was in effect equivalent to a supplementary income or ability tax and would rest upon those especially benefited by growth in values. It was further urged in justification of the tax that when a land owner secures an appreciable increase in the value of his land, either through the action of the government or through the general growth of the community, a part of his profit might equitably be diverted to the public use. So far, however, the recommendations of the committee as to an increment tax have not been enacted into law.

While the increment tax has not so far been adopted by any American community, the principle of the tax has been in use in several other countries for some years past. An Imperial increment tax was adopted in Germany in 1911, which in a large measure replaced local taxes. It has been in successful operation in

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several hundred German cities for a number of years. In England the celebrated Lloyd-George budget of 1909 introduced an unearned increment tax which appropriates to the public use a fifth of all increases in land values greater than 10 per cent. The province of Alberta, Canada, adopted an increment tax in 1913, the details of which are described on another page. That it will eventually be adopted by some of the American commonwealths is not at all improbable.

Partial Exemption of Buildings

Another proposal for special land taxation involves a heavier direct tax on land than on buildings and improvements on land. The principle of total or partial exemption from taxation of buildings and improvements on land has been quite widely discussed and has many advocates in this state. While total exemption has a considerable following, partial exemption is more generally urged, because less radical and less liable to seriously affect our local revenue system under existing tax limitations. Moreover, partial exemption could be brought about through legislative enactment, while total exemption would require a constitutional amendment.

The arguments used by the advocates of total or partial exemption of buildings and improvements are of much the same tenor as those used by single taxers. In addition, however, it is contended that land is the fundamental base of an equitable tax system. It has a fixed situs and can neither be moved nor concealed. Its value can be measured with reasonable accuracy, and therefore can be taxed with greater certainty and equality than other forms of property. Moreover, it is claimed, the taxing of buildings discourages improvements, because it imposes a fine in the form of a tax on the man who improves his property, thus penalizing thrift and industry. It is further contended that if all taxes were levied on the land it would compel the owner of idle land to improve it, or to sell it to others who would improve it, thus eliminating the speculator who does nothing to create values in a community, but, under our present system, profits by the energy and enterprise of others.

Partial Exemption in the United States

The movement in the United States for the exemption of improvements has so far made but little progress. The only direct

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legal application of the principle at the present time is to be found in the cities of Pittsburgh and Scranton. In 1913 the Pennsylvania legislature passed an act providing for the gradual partial exemption of improvements from taxation in cities of the second class, of which Pittsburgh and Scranton were the sole members.

The law provides for an initial reduction of one-tenth of the value of buildings in 1914, and a second 10 per cent in 1916. Thereafter, a further reduction of 10 per cent is to be made every third year until 1925, when the assessment of buildings will equal 50 per cent of value, at which figure it is to remain stationary. The reduction applies to municipal taxes only, and does not affect county or school rates.

In 1912 the city of Everett, Washington, adopted an amendment to its charter providing for the exemption of improvements from taxation. The amendment provided that for the years 1912 and 1913, 25 per cent of the value of buildings should be exempt from taxation, 50 per cent for the years 1914 and 1915, 75 per cent for the year 1916, and thereafter complete exemption.

The amendment, however, has never been put into effect. Shortly after its adoption, the state tax commission ruled that it was unconstitutional, inasmuch as it violated the provision of the state constitution requiring all property to be assessed in proportion to its value, and instructed the local assessor to disregard it. While threats of legal action have been made, the friends of the measure have so far failed to test its validity in the courts.

In 1913 the city of Pueblo, Colorado, adopted an amendment to its charter providing for a 50 per cent exemption of improvements in 1914, and thereafter an exemption of 99 per cent, the 1 per cent being retained to forestall possible legal complications. The taxes of 1914 were levied on the basis of 50 per cent of the value of improvements, but the measure was repealed by a close vote before the 99 per cent exemption became effective in 1915.

Several states, particularly in the West, have voted in recent years on some phase of total or partial exemption of improvements from taxation, but so far the principle has not been written into the constitution of any of the American commonwealths.

The Movement in New York City for the Partial Exemption of Buildings

While the West seems to have offered the most inviting field for the spread of the single tax doctrine in so far as it relates to

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the exemption of improvements from taxation, yet recently the principle of such exemption was given serious and thoughtful consideration by the committee on taxation of the city of New York. This committee, consisting of twenty-five members, was appointed by Mayor Mitchel in April, 1914, pursuant to a resolution of the board of estimate and apportionment, for the purpose of making a study of the several methods of taxation in use in that city, and in other cities of this country and abroad, and to suggest any changes in the taxing system of the city that, in the opinion of the committee, would effect an improvement in the ways and means of creating the necessary public revenue to defray the cost of the city government.

The committee directed its attention principally to two distinct lines of inquiry: (1) the advisability of reducing in whole or in part the tax on improvements on land in the city of New York; and (2) the best available method of increasing the public revenues of the city. It is with the former question that we desire here to deal.

Two proposals for exemption were considered by the committee: (1) the taxation of buildings at half the rate applied to land; and (2) at a rate of 1 per cent of that applied to land, the first being a 50 per cent exemption, and the second practically total exemption.

On the question of exempting improvements from taxation, or the untaxing of buildings, as it was called in the report, various studies were initiated immediately upon organization of the committee. Letters containing five elaborate series of questions relating to the many different aspects of the problem were sent to a large number of organizations and individuals interested in taxation, and a number of able briefs, pro and con, were submitted to the committee. Public hearings were held at which both the advocates and opponents of the plan were heard, ample opportunity being given for a thorough discussion of all phases of the problem.

In addition to these activities the committee engaged the services of an expert and entrusted him with the duty of investigating and reporting upon the practical working of the so-called single tax in western Canada, and in the few American cities where the plan had been tried. The expert spent several months in a careful investigation of the taxing system of the Canadian West and its effect on the social and economic progress of that country. His

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report to the committee, while containing much valuable and interesting information, was somewhat inconclusive in its findings and recommendations, and was subsequently used by both the advocates and opponents of exemption in support of their respective arguments.

The final report of the committee was presented in January of the present year. A majority of the committee recommended "against the adoption of the principle of untaxing buildings, gradually or otherwise." The minority report, while favoring the total exemption of buildings, to be put into effect gradually, was not averse to a law requiring a progressive reduction until the rate on buildings should be one-half the rate on land, believing the reduction would prove so satisfactory that ultimately the public would demand complete exemption of buildings.

The arguments of those favoring the untaxing of buildings were summed up under seven heads, of which the following is a brief summary:

1. The advocates of exemption contended that land is a gift of nature, while ordinary commodities are the product of human energy; that land values are created by the community, while other values are created by labor, and that the former, being a social product, should bear the tax burden, while buildings, being the product of labor, should be exempt. It was further contended that exemption of buildings would result in increased building activity, and would therefore tend to increase wages and to diminish unemployment.

2. Land is essentially a monopoly, because the supply of land available for buildings cannot be increased. Since land is a monopoly, its price should be controlled by the government, and the best method of such control is through the agency of taxation, while buildings, being subject to the ordinary competitive law, do not need this control. Buildings should, therefore, be exempted from taxation, while land alone should bear the burden.

3. Land speculation is one of the great evils of modern city life. It results in large tracts of land being held out of use, and is one of the causes of high rent, and one of the chief reasons for the need of exorbitant sums for supplying rapid transit facilities. Land values have increased over a thousand million dollars in New York City during the past decade, while business in general was

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poor. Interest on this increase means a large annual charge that must be paid by manufacturers, business men in general, tenants and home owners. It constitutes a dead weight fixed charge upon the workers of the city, and being a benefit to the speculator only, he should be compelled to suffer the burden of the tax. Gradually transferring taxes from buildings to land values, during a period of ten years, would prevent most of the speculative increase in the selling price of land, and would thus save the community this fixed but wasteful charge.

4. The exemption of buildings will lead to lower rents. These lower rents will apply not only to the tenants of residential apartments but to the tenants of commercial structures. In either case, there will be an economic saving, due to reduced rents. In the case of tenements, the lower rent will mean an increased surplus to be divided for general purposes, which will tend to increase wages and lessen unemployment. In the case of lower rents for business purposes, it will make the city more attractive to industrial ventures, and will, to the extent of lessening taxes, increase the funds available for the payment of wages or the investment of capital, and thus contribute to general prosperity.

5. The exemption of buildings will tend to lessen congestion, either by the lowering of rents or by providing larger rooms and better accommodations at the same rental. It will tend to replace rookeries with improved dwellings, and will thus help to stamp out disease and to better the physique and morals of the people.

6. The exemption of buildings will lessen the present tendency to erect tenement houses and flats. It will make it more profitable, and therefore more attractive, to intending owners of small homes in the suburbs to erect their own homes, thus helping to prevent the repetition in the outskirts of the city of the slum conditions in the center.

7. Apart from any of the above considerations, buildings ought to be exempted from taxation because the financial benefits of city expenditure accrue exclusively to the land owner. The building of a school house increases the value of the adjoining land. The construction of a subway creates or augments land values. All expenditures of the city ultimately accrue to the advantage of the land owner. If any advantages at all come to other members of the community through city expenditures, they have to pay for these advantages in the increased rent they are required to pay

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to the owners of the real estate. For these reasons buildings should be exempted from taxation.

The opponents of the exemption of buildings from taxation, in answering the arguments of the advocates of exemption, characterized them as inconclusive and contended that many of the alleged benefits of the policy of exemption were purely imaginary. The arguments of the advocates of exemption were taken up and answered in the order in which they were advanced. The answers may be briefly summarized as follows:

1. As a general philosophy of economics and social life, it is denied that land is so entirely different from other kinds of wealth. While it is true that land is a gift of nature, it is also true that a great part of the so-called products of labor are also gifts of nature. The wood that goes into a table, or the wool that goes into a suit are the gifts of nature. It is denied that a consistent distinction can be made between land values as community-made values, and other values as man-made values. Demand gives value to everything, and without demand, labor products would have no value. Demand is as insistent and important in the case of labor values as it is in the case of land values.

It is contended that value in modern life does not come so much from the application of labor as it does from a variety of relations and privileges, and that as these speculative relations and actual privileges enter so importantly into all forms of modern income, it would be unfair to draw a hard and fast line between land values and other values.

2. It is denied that land is a monopoly. There are about two hundred thousand individual land owners in New York City, the great majority of whom are married men. Assuming that a family consists of five members, there would be one million people directly or indirectly owning land in the city. It is also claimed that by far the greater part of land in New York City is mortgaged, and that as real estate mortgages are held largely by savings banks, life insurance companies, and similar institutions, the real owners of the land in the city are the depositors of savings banks and the policyholders of the insurance companies. It is therefore absurd to speak of land as a monopoly. Moreover, it is denied that land is unduly held out of use, but, on the other hand, is improved just as soon as it will pay the owner to erect a building on it.

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3. Speculation in land is not a crime against society. Land speculation is not essentially different from speculation in other things. Without speculation there would be far greater fluctuations in the prices of ordinary commodities. It is the speculative expert who takes the risk for the community. Speculation in land is, therefore, just as legitimate and necessary as speculations in anything else.

4. Admitting that the incidence of a tax on buildings is different from the incidence of a tax on land, it does not follow that the exemption of buildings from taxation would result in lower rents. A house owner counts upon the future normal increase in land values to make good the deterioration in the value of the buildings, the growth in land value constituting an amortization fund for the house. If this virtual amortization fund disappears because of a change in the method of taxation, it will be necessary to create an actual amortization fund. This would increase the carrying charges of the buildings and would result in augmenting rather than in reducing rents. Moreover, it is claimed, wages and rents move along together and that the reduction of rents would not increase wages, nor would the exemption of buildings result in any permanent lessening of unemployment.

5. Replying to the argument that the exemption of buildings would reduce congestion, it is claimed that while it might reduce congestion per room, it would increase congestion per acre, and that whatever benefits might ensue from the former would be more than offset by the latter. It would result in a more intensive use of land by erecting skyscrapers in the business district and lofty tenements in the outlying districts. While the destruction of the slums would be a good thing, the benefits would be more than overbalanced by the conversion of whole sections of comparatively low buildings into sections of high and densely populated structures, thus greatly increasing the congestion per acre.

6. The alleged advantage to the small householder is held to be largely illusory. As almost all improvements in New York City are made through mortgage loans, the decrease in the capital value of land due to increased taxation on land, will so impair the security for loans, it is claimed, that either interest rates will rise, or a smaller percentage of capital will be loaned at the same rate of interest, as when the ratio of the loan to the value of the property is increased interest is also usually increased. This would result in an

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increased expense to the intending home-builder and would offset any advantage that might accrue to him from the decrease in taxes.

7. The argument that the benefits of city expenditure accrue exclusively to the land owner is fallacious. City expenditures, as a rule, benefit the entire community. Fire protection and police protection redound to the benefit of the people who own personal property as well as to the people who own real estate. The purpose of courts is to dispense even justice between individuals, regardless of the nature of the property they may own, so that all the people enjoy the benefits of courts, as they do of a subway, or of public schools and hospitals, and other public institutions. City expenditures, it is claimed, afford increased opportunities for gain, and therefore benefit the laborer, the merchant, and the manufacturer, whether they own land or not. Inasmuch as the entire community benefits by such expenditures, it would be unfair to require land to bear the entire burden of government.

In rebuttal of some of these arguments, the advocates of exemption denied that their scheme involved any element of confiscation. Some of them contended that instead of land values decreasing, there would be an increase in such values because of the greater demand for land which would come from the increased building activity resulting from the exemption of buildings. The predicted real estate panic, should the scheme be adopted, was characterized as a mere figment of the imagination. As to the effect of the change on public debt, it was held that it would be a good thing for the taxpayers if obstacles were put in the way of any further increase in the public debt for some time to come. Finally, it was contended, that while some people might suffer slight financial loss from the change, it would be generally beneficial to the community, and that the injury to the few should not be permitted to outweigh the good to the many.

The personnel of the committee was of a high order, a number of its members having devoted years of study to social and economic problems. As would be expected from such a body of men, the arguments by both sides in support of their respective contentions were vigorously presented. The logic of the arguments, however, was not always clear, being influenced undoubtedly to some extent by personal predilection. Nevertheless, it is an able and interesting report, and while from a theoretical viewpoint the advocates of exemption made out the stronger case, from the viewpoint of present expediency the opponents of exemption had the better of the argument.

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The Exemption from Taxation of Buildings and Improvements on Land in Western Canada

In the biennial report of this commission for 1912 a brief chapter was devoted to the taxation of land values, particular attention being given to the total or partial exemption from taxation of buildings and improvements on land. The purpose of the report at that time was to present in a concise and impartial manner the experience of western Canada in the practical application of some of the principles of the so-called single tax. It was intended to be educational rather than argumentative—to be an impartial outline of their taxing system without either approval or condemnation of its economic soundness. While it was misunderstood in some quarters, it accomplished its purpose, for it was widely read and discussed, not only in our own state, but in numerous other states, both East and West.

Last year a second investigation of the taxing system of the western Canadian provinces was undertaken by a member of this commission. This visit was prompted by a desire to observe the working of the tax system of these provinces under the somewhat depressed business conditions that followed the boom of a few years ago.

The information obtained during this recent visit has since been supplemented through correspondence with a number of officials and other persons interested in the general subject of taxation in that country. It is our purpose here to briefly review our original report.

When the investigation of its taxing system was undertaken by this commission four years ago, conditions were exceedingly prosperous in the Canadian West. Its fertile prairies were attracting settlers by the thousands, and cities and villages were springing up as if by magic. The settlers came mainly from the eastern provinces of Canada and from the United States, with a sprinkling from European countries. They were a vigorous, progressive class of people, having almost the same ancestry as those who had made the American West great and prosperous, and were imbued with an ambition to better their condition in life, both socially and financially.

The influx of settlers to the Canadian West was followed by the rapid organization of numerous municipalities. With the

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organization of municipalities came the necessity of public revenues. How the necessary revenues to defray the cost of the newly organized municipalities could be equitably raised at once became a pressing public question.

The Canadian West offered an excellent field for experimentation in the theories of taxation. The country, as well as its revenue system, was in the making. It was not hampered in its fiscal policy, as some older states, by a practice hoary with age and hallowed by years of quiet submission. Precedent had not become grafted on the body politic. It was free to blaze new trails in the field of taxation if it so desired. And it did.

The new settler was a cosmopolitan. He was ambitious. He had emigrated from the place of his nativity because he was dissatisfied with his environment. He wanted to better his condition. And so he was willing to experiment in governmental theories in the new country of his adoption.

Not only did the economic conditions of the West make it a good field for experimentation, but the Canadian scheme of local government offered a much wider latitude for the testing of governmental theories than that of our own states. The legislatures of the Canadian provinces are invested with much greater legislative powers in matters of taxation than most of the state legislatures of the American commonwealths. Their powers are much less restricted by constitutional provisions than ours. Each provincial legislature may devise its own scheme of direct taxation without let or hindrance, so far as the constitution is concerned. It may impose taxes on land, or personal property, or income, or all of them, or it may exempt any class of property from taxation by legislative enactment. In addition, it may delegate to a municipality the exclusive power to tax or exempt any class of property. It is this delegated power that has enabled a number of the western Canadian cities to devise their own schemes of taxation.

This wide latitude in the powers of the legislature results, as was explained in our report of four years ago, in a wide diversity of tax systems in the different provinces of Canada, as well as in different municipalities of the same province. None of the western provinces imposes a state or provincial tax on lands, except in unorganized districts, nor is any state tax imposed on personal property, except in British Columbia. State revenues are derived

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principally from special taxes and fees and from the Dominion subsidy.

The power to tax or exempt property delegated to a municipality is usually a restricted one, though in some cases there seems to be no limitation on the taxing power of a municipality. Under the Canadian taxing system there is entire separation of the sources of state and local revenue. The delegated power to tax or exempt property means local option in taxation, and results, as would be expected, in a wide diversity of tax systems in the different municipalities.

The taxing systems of the four western Canadian provinces, Manitoba, Saskatchewan, Alberta, and British Columbia, were described in considerable detail in our report of four years ago. A brief resume of their respective tax systems may be of interest.

It should be noted that the term "single tax," as it appears in the following review of the taxing system of western Canada, is used in its restricted sense, and means a tax on the value of the land, exclusive of the value of buildings and improvements on the land.

Taxation in Manitoba

The province of Manitoba, lying in part to the north of this state, imposes no state or provincial tax on real or personal property. The public revenues are derived mainly from taxes on certain public service corporations, from inheritance taxes, from the sale of public land, and from the Dominion subsidy, the latter being an annual subvention or grant made by the Dominion government as compensation for the surrender of certain rights and privileges by the provinces when the Canadian confederation was formed. Considerable revenue is also derived from the telegraph and telephone system of the province which is owned and operated by the government.

Municipal taxes are governed by a general law, known as the Assessment Act, except in the cities of Winnipeg and Saint Boniface, which operate under special charters. A municipality may impose taxes on real property subject to certain exemptions, the exemptions being similar to our own. The personal property tax is restricted in its application, no tax being imposed on household goods, or on the live stock and farm tools of the farmer used and

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kept on the premises of the owner. To encourage mixed farming, creameries and cheese factories are also exempted from taxation. Cities and villages may, under certain restrictions, impose a business tax in lieu of personal property taxes.

Winnipeg, the capital and principal city of the province, derives its public revenues mainly from real estate, business and franchise taxes, supplemented by receipts from a large number of business enterprises owned by the city.

Prior to 1909, land and buildings in Winnipeg were assessed and taxed on the same basis of value. An amendment to the city charter, adopted in that year, authorized and directed the assessment of land at full value, and the assessment of buildings at two-thirds of full value. This provision of the charter is still in force and seems to be generally satisfactory to the taxpayers, although a considerable sentiment in favor of a still further reduction in the assessment of buildings is to be found in the city.

The business tax of the city, which was introduced in 1893 as a substitute for the personal property tax, is now imposed on the rental value of the premises occupied by the business, the rate being 6 2-3 per cent. The rental value is determined by the assessor, and may be more or less than the actual rental, if the actual rental does not represent the assessor's judgment of the true rental value of the premises. While there is some opposition to the business tax, especially among retail merchants, it is generally regarded by business men as better and much more satisfactory than the personal property tax.

Taxation in Saskatchewan

No provincial tax is imposed on either real or personal property in Saskatchewan, the public revenue being derived from sources similar to that of Manitoba. The province, however, does administer certain special land taxes for the benefit of the municipalities. A tax of 4 cents per acre is levied on land, the proceeds of which are used to meet the losses to crops by hail, the tax being known as the "hail insurance tax." This tax, however, is optional with each municipality, and when levied and collected the proceeds are turned over for administration to a commission known as the municipal hail insurance commission, no part of it going to the provincial government.

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A tax of 1 cent per acre is also imposed on lands not included in any town or village school district, and a tax of one-half cent per acre on those who hold government lands leased for grazing purposes, the proceeds of both taxes being apportioned to certain educational institutions.

In rural municipalities taxes are imposed on lands only. Buildings and other improvements on lands and personal property are entirely exempted from all forms of taxation. Formerly a flat acreage tax was imposed on land, but in 1914 the law was changed and the tax is now imposed on the basis of value. In assessing land, only the original value is considered, any increase in value due to the expenditure of "capital or labor" being omitted from the taxable value.

Rural municipalities also impose a "surtax" on vacant land. This tax was first imposed in 1914 and was intended to discourage speculation in land and the holding of land out of use. The tax is 6¼ cents per acre and applies to the following lands:

1. The land of any owner or occupant not exceeding 320 acres which has less than one-quarter of its area under cultivation unless such owner or occupant is an actual resident upon such land.
2. The land of any owner or occupant exceeding 320 acres but not greater than 640 acres which has less than one-quarter of its area under cultivation.
3. The land of any owner or occupant exceeding 640 acres which has less than one-half its area under cultivation.

While the surtax law has not yet been tried out a sufficient length of time to determine its effect on speculative holdings, it is regarded with favor by the settlers. On the other hand, as would be expected, the law is severely criticised by nonresident land owners.

In reply to a recent request for information as to the success of the surtax, a prominent government official writes as follows:

> The surtax, to which you make reference, is almost unanimously endorsed by the officials of our two hundred and ninety-seven rural municipalities. It was intended, as you know, to discourage the witholding of large areas of land from cultivation. Some have described it as a "speculator's" tax. It has a tendency to force those who hold lands for higher prices to dispose of the property. In too many instances has the land of the non-resident increased in value through no effort of his own, but largely on account of the pioneers of the community who are actually farming and producing wealth from the soil. On the other hand, non-resident owners of large areas complain that when the land is too far removed from a railway, it is impossible to sell the property or have it cultivated. Cultivation relieves the owner from taxation. At a time when there is no sale for land, no doubt the burden seems heavy on those who have to pay the surtax, but it can always be argued that if the property is farmed, the special rate of six and one-quarter cents per acre is not imposed.

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Villages may tax real and personal property and income. Buildings, however, cannot be assessed at more than 60 per cent of value and may be entirely exempted, as may personal property, by action of the village council upon petition of two-thirds of the resident voters of a village.

That the principle of exempting buildings is growing in favor is evidenced by the fact that the number of villages taking advantage of the optional provision of the law is steadily increasing, and now embraces nearly one-third of all villages in the province.

In Saskatchewan, the term "town" as applied to a taxing district has much the same meaning as the term "village," the differ ence being one of population. A village may be incorporated with a minimum population of fifty people, while to incorporate as a town a given area must have a minimum population of five hundred people.

As in villages, towns may impose taxes on lands, including buildings, and on business and income. Under a law enacted in 1911, buildings cannot be assessed at more than 60 per cent of value, while land is to be assessed at full value. The law also provides that the assessment on buildings may be further reduced but not at a greater amount than 15 per cent in any one year. So far only a few towns in the province have availed themselves of this optional provision, and none of them to the extent of total exemption of buildings.

The cities of the province are operating under practically the same tax laws as towns. Lands are taxable at full value and buildings at not more than 60 per cent of value, with an optional reduction on the latter of not more than 15 per cent annually until entire exemption is reached.

All of the cities of the province have exercised their right to reduce the assessment on buildings, the highest assessment in any city being now 45 per cent and the lowest 15 per cent of full value. It would therefore seem that the cities regard a lower assessment on buildings with greater favor than their smaller urban sisters, the towns of the province.

While there is a considerable diversity of opinion as to what effect the reduction of assessments on improvements has had on building operations in the cities, the consensus of opinion seems to hold that the system has stimulated building activities to a notice-

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able extent. On the other hand, it was contended by some people that the system of exempting improvements from taxation had resulted in over-building and was largely responsible for the depression of a year ago. This opinion, however, was confined to comparatively few people.

Speaking in general terms, the public sentiment of the province seems to be largely in favor of imposing a higher tax on land than on buildings, while not an inconsiderable sentiment exists in favor of the entire exemption of the latter. This sentiment has been recognized in the tax legislation of recent years, the laws now permitting the total exemption of buildings at the option of the community. While only a few districts in the province entirely exempt buildings from taxation, a number impose only a nominal tax on such property, and none at a higher rate than 60 per cent of value.

Taxation in Alberta

In some respects the trend toward the single tax has been more pronounced in Alberta than in any of the other Canadian provinces. In 1912 laws were passed making land values, exclusive of buildings, the sole base of taxation in the rural municipalities, villages and towns of the province. In 1913 an increment tax law was passed imposing a tax on the future unearned increase in the value of land.

Unlike Saskatchewan, which permitted the gradual exemption of buildings from taxation, Alberta eliminated taxes on both buildings and personal property at one stroke in all of the taxing districts of the province except in the cities and in two towns. And again unlike its sister province, the total exemption of buildings and personal property in the villages and towns of Alberta was not optional, but was forced upon them by legislative enactment.

As would be expected from such a sudden and radical change in the tax base, the new law seriously upset the revenue system of some of the towns of the province. The new system resulted in a considerable reduction in the taxable value of property, and with a limitation on tax rates, some of the towns found it difficult to raise sufficient revenue to meet their financial obligations. This difficulty, however, was overcome by a subsequent law which removed the limitation on tax levies.

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In assessing property, the law provides that land shall be appraised at its actual cash value, and defines such value to be the amount at which it would be "appraised in payment of a just debt from a solvent debtor." In addition to excluding buildings from the valuation, the law further provides that any increase in value "caused by any other expenditure of capital or labor thereon" shall also be excluded from the taxable value of the land.

The Increment Tax

The province of Alberta was the first state on the American continent to adopt an increment tax. A law was enacted in 1913 imposing a tax of 5 per cent on the future increase in the value of land, providing such increase was not due to the cost of improvements or development work on the land. The tax is payable upon transfer of the property, payment being made a necessary condition to the registration of the transfer. The tax is not imposed on the transmission of the lands of a deceased person to his heirs, nor upon the registration of land grants from the government.

Farm lands, within certain limitations, are exempted from the provisions of the law. If 10 per cent of the land was under cultivation and was actually used for agricultural purposes by the transferrer during the twelve months preceding the transfer, and the area does not exceed 640 acres, it is exempt from the increment tax. Areas in excess of 640 acres in which the transferrer had a beneficial interest immediately preceding the transfer are subject to the 5 per cent tax, but only to the extent of the excess beyond the sum of fifty dollars per acre.

The municipal assessments of 1913 were adopted as the basis from which future increases were to be computed. As large areas of land were in unorganized districts at that time, a provision was inserted in the law establishing an initial base of fifteen dollars per acre, when such lands are brought within the limits of a municipality, from which future increases are to be computed.

The increment tax has been in effect such a short time that any statement on our part of its success or failure would be a mere expression of individual opinion. In a recent communication, however, a prominent government official says the law is working very satisfactorily.

So far the revenue derived from the measure has not been large. The initial levels of value from which future increases

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are to be measured, were quite high, and with the recent depression in the movement of real estate, it will probably be some time before any considerable amount of revenue will be derived from the tax.

The Wild Land Tax

In addition to the increment tax, Alberta also levies a special tax for provincial purposes of 1 per cent on unimproved or "wild lands" not within the corporate limits of any city, town or village. Lands on which homestead entry has been made; lands leased from the government for grazing purposes; farm lands not exceeding 640 acres, when occupied by the owner, as well as the lands of any owner if one-fourth of the area is under cultivation, are exempt from the 1 per cent tax.

The law, which became effective in 1915, has not been in operation a sufficient length of time to determine what, if any, effect it has had on speculative or unimproved holdings. However, the friends of the measure seem to think that they can already discern a greater disposition to unload speculative holdings or to improve lands than formerly, due to the so-called "wild lands" tax.

The Cities

The cities of the province depend almost entirely on land taxes for public revenue although some of them still impose taxes on buildings and personal property. This is particularly true of Calgary, the largest city in the province, in which buildings are assessed at 25 per cent, and certain classes of personal property at 66 2-3 per cent of value.

Edmonton, the capital city of the province, is probably the most pronounced exponent of the single tax principle of any of the larger Canadian cities. No tax has been imposed on buildings in that city since 1904. Business, income, and poll taxes were retained for some time subsequent to that date, but they have now all been abolished. Land value, exclusive of buildings, is now the sole tax base.

In order to prevent congestion and lessen the fire hazard, a limitation is placed on the height of buildings that may be erected within the city. Non-fireproof structures are limited to a height not exceeding fifty-five feet; fireproof factory, warehouse, and store buildings to one hundred feet, and other fireproof structures to ten stories.

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The city has had a remarkable growth in recent years and is now one of the most substantial urban centers in the Canadian West. While there is some diversity of opinion as to the effect the single tax has had on the growth of the city, a large majority of those consulted regarded the system with favor, and contended that it not only stimulated building activity, but greatly encouraged home ownership in the city. That the single tax principle is generally satisfactory is evidenced by the fact that there is at the present time no noticeable trend, after a dozen years' trial of the system, to return to the taxation of buildings and personal property.

Taxation in British Columbia

British Columbia, the Pacific coast province of Canada, levies no state tax on land, except in the unorganized districts of the province. The sole right to tax real estate in the organized districts is delegated to the municipalities. A provincial tax, however, is imposed on certain classes of personal property, and upon income.

Lands in the unorganized districts are classified for purposes of taxation as improved, wild, timber, and coal lands, a different rate of taxation being imposed on each class. The law was evidently intended to encourage the cultivation of land, the rate on improved lands being only one-half of 1 per cent of value, while wild lands are taxed at the rate of 4 per cent.

British Columbia is rich in timber lands but they are treated tenderly so far as taxation is concerned, being subject to a tax of 2 per cent, which may be rebated if the timber is manufactured or used in the province.

In the taxation of coal lands, the province favors the operating mine as compared with the unworked mine, the former being taxed at 1 per cent, while the idle mine pays a tax of 2 per cent.

The Municipalities

The municipalities of the province are prohibited by law from taxing improvements on land at a greater rate than 50 per cent of value, while the land itself is subject to assessment at full value. The law, moreover, leaves it optional with a municipality to assess improvements at less than 50 per cent of value, or to entirely

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exempt them. In practice, more than one-half of the municipalities of the province now entirely exempt improvements from all taxation.

Evidently the law governing taxation in municipalities was not intended to favor the speculator, or to encourage the holding of land out of use, for it permits the taxation of unimproved, or "wild lands," at a special rate. Municipalities may impose a rate of 5 per cent upon lands on which the value of existing improvements is less than ten dollars per acre, while the rate on improved lands is limited to 1½ per cent for general purposes.

The City of Vancouver

Vancouver, the metropolis of British Columbia, has received more free advertising because of its taxing system than any other city on the American continent. It was the first city of any considerable size in Canada to adopt the principle of entirely exempting buildings from taxation. Its experiments in the field of taxation along single tax lines were watched with keen interest and were widely discussed on the lecture platform and by newspaper and magazine writers in this country. Much was said and written of the system that was true; not a little of it was tinctured by the personal sympathy of the speaker or writer.

The process of exempting buildings from taxation in Vancouver was a gradual one. The first step toward exemption was taken in 1895, when the assessment on buildings was reduced to 50 per cent of value, followed in 1906 by a further reduction of 25 per cent, and in 1910, by entire exemption.

The influence of exemption on the building activity of the city is a subject of considerable dispute. The friends of the system claim that its effects were almost magical; that it immediately resulted in greatly increasing building activity in the city, and point, as proof of their statement, to the large number of office buildings and business blocks, as well as residences, that sprang up in the city immediately following the adoption of the principle of total exemption of buildings.

On the other hand, the opponents of exemption contend that the increased building activity was simply coincident with the change in the taxing system; that the real cause of such increased activity was the large influx of people and capital, attracted to

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Vancouver by its great natural advantages and not by its taxing system; that it was the usual response to the law of supply and demand, and that total exemption had little, if any, influence at that time in stimulating building activity in the city.

That the marvelous growth of the city a few years ago was almost entirely due to the untaxing of buildings is probably an exaggerated claim. On the other hand, the impartial investigator is forced to the conclusion that the adoption of the policy of total exemption resulted in an immediate and marked increase in building activity in the city.

It would be a mistake, however, to suppose that the policy of exempting buildings meets with unanimous approval. Many of the business men of the city are strongly opposed to the policy of exemption. This is particularly true of many real estate dealers, and is especially true of large holders of unimproved or underimproved property. The principle of exemption, however, has the approval of a large majority of the people, and there is no present indication that the city is likely to return to the plan of taxing buildings at the same rate as land. This attitude of the majority is reflected in the action of the aldermen, with whom the question of exemption rests, in unanimously voting last year in favor of continuing the policy of exempting buildings from taxation.

Conclusions on the Canadian Taxing System

Four years ago, in the final summary of our report on the taxing system of western Canada, we said that the trend was distinctly and strongly in the direction of the single tax; that it had been reasonably satisfactory wherever tried; that there was no movement of any particular strength toward a return to the old system of taxing buildings at the same rate as land; that indications at that time pointed to the probability that eventually the single tax principle would be in effect in all of the western provinces.

Our recent investigation has not materially modified our conclusions of four years ago. The principle of total or partial exemption of buildings and improvements is of much wider application now than it was at that time. The movement, however, in the direction of a further spread of the single tax principle is not as active now as it was four years ago. Indeed, it may be said the movement is now dormant.

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This condition of dormancy is due in part at least to the general business depression that prevailed throughout the country during the past few years, which, however, is now gradually disappearing. Following the collapse of the boom of five or six years ago there was a sharp decline, not only in real estate values, but in the movement of real estate as well. Many owners of property, and especially of unimproved property, found themselves unable even to pay the taxes on their lands, much less to sell them. As a result, the percentage of unpaid taxes became increasingly large and because of this large delinquency many of the cities found it difficult to meet their financial obligations from current tax receipts. While such conditions prevailed it was scarcely to be expected that any further reduction would be made in the tax base. The percentage of tax delinquency was much greater on unimproved than on improved property, hence to reduce the tax on buildings was to reduce the most dependable source of public revenue. Under such circumstances, as would be expected, the movement toward the single tax principle became suddenly halted and is still dormant.

It is true that in some sections of the country where buildings are entirely exempted from taxation a considerable sentiment is to be found favoring a return to the principle of partial exemption only. In the larger cities this sentiment is due in part to a feeling that structures of the skyscraper type, having deep foundations which require deep sewers, add greatly to the cost of fire protection, as well as to the initial cost of an adequate sewerage system. It is contended that it is only fair to require such structures to bear a part of this increased cost. Some would tax them only on the excess height above four or five stories.

In other sections of the country, the growing sentiment in favor of partial exemption only is due to a desire for a larger tax base. They are greatly in need of more revenue but are reluctant to increase the tax rate on land, so they propose a tax on the partial value of buildings as a feasible and easy method of increasing the public revenues. Because of this pressure it is not improbable that some of the municipalities that now exempt buildings will restore the tax on them, but probably at not more than 25 per cent of value.

In conclusion it can be said that the single tax principle is still deeply rooted in the Canadian West. It has been tested under

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both prosperous and adverse business conditions, and it has stood both tests fairly well. Nearly any tax system will succeed, or pass unnoticed, in prosperous times; the real test comes in times of adversity. While the Canadian system has not been uniformly successful under adverse business conditions, it is doubtful if the old system would have been any more successful under the same circumstances. That the opponents of total exemption are more numerous now than they were four years ago is generally admitted. It is claimed, however, that any change in public sentiment is due to the pressure of revenue needs, rather than a changing view of the single tax principle. While the system may not be further extended for some time, and not until business conditions have considerably improved, it is highly improbable that any section of the country will again return to the old method of taxing buildings on the same basis as land.

THE EFFECT THE SINGLE TAX WOULD HAVE ON THE INCIDENCE OF TAXATION IN MINNESOTA

The Present System

The existing system of taxation in Minnesota is known as the general property tax. The general property tax may be briefly defined as a tax on the value of all kinds of real and personal property not specifically exempted by the state constitution, regardless of whether the tax is imposed on the full value, or on a percentage of value, or in specific amounts on value.

The measure of value of a large part of the taxable property of the state is the **selling** value of the property as determined by assessors and boards of review and equalization. The value of some property, however, is measured by gross income or gross earnings, such as the property of railroad companies, freight and express companies, telephone companies, and certain other public service corporations. The former is subject to a millage tax; the latter to a specific tax on gross earnings.

The original tax provision of the state constitution required taxes to be equal and uniform upon all classes of property, the law requiring the assessment to be made at the full value of the property. In the earlier history of the state the full value provision of the law was fairly enforced. As property grew in value and volume, however, assessing officials gradually began to ease

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away from full value, until finally assessments were made in the rural districts at from 20 to 30 per cent, and in the cities and larger villages at from 30 to 50 per cent of value. Custom superseded law, and undervaluation became general.

So firmly did the practice of undervaluation become established that it finally obtained almost the force of law. In a measure, the illegal practice was recognized by the legislature through the enactment of numerous tax and revenue laws based on an undervalue assessment. Laws regulating public debts, fixed tax levies, and the salaries of many public officials were based on assessed values when it was known at the time of the passage of such laws that the assessment was not made on the basis of value required by law.

This disregard of law in the assessment of property resulted in serious tax inequalities in the different counties of the state, and often in the different taxing districts of the same county. Realizing that a just and equitable assessment of property was impossible under a system that, in effect, permitted each taxing district to determine its own basis of valuation, the legislature of 1913 undertook to remedy the evil.

Several suggested reforms in the method of assessing property were proposed. Not a few people advocated changing the laws relating to public indebtedness and tax levies, thus permitting property to be assessed at full value as required by law. Others favored establishing a new basis of valuation at some percentage of value less than full value—say 50 per cent—upon which assessments could be made without seriously disturbing the existing revenue system of the state. Still others advocated the classification of property along the lines established by the practice of undervaluation so long followed in the state. It was contended that the people had become so accustomed to undervaluation, and had so adjusted public revenues and expenditures to the practice, that any sudden material increase or decrease in the tax base would not only seriously disturb public affairs, but might be harmful to many of the taxing districts of the state.

The idea of classification prevailed and resulted in the enactment of the so-called classified assessment law. The classified assessment law was based on an amendment to the state constitution, adopted in 1906, changing the tax rule from uniform on all property to uniform on the same class of subjects. The new law

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did not materially change the existing tax base. In effect, it validated the custom of undervaluation that prevailed under the old law, and, while to some extent the classification was based on expediency rather than on sound economic reasoning, yet from almost any viewpoint it is a decided improvement over the old system. The new law can be strictly enforced; the old law was incapable of successful enforcement. The change represented the difference between law and anarchy in the assessment of property.

Under the classified assessment law all property, other than property subject to a gross earnings or lieu tax, is divided into four classes for purposes of taxation, the classes being fully explained in another part of this report. All property subject to the general tax is required to be assessed at its true and full value. The tax, however, is extended at a percentage of full value varying from 25 to 50 per cent, according to the class in which the property falls.

While the rate of levy is uniform on the **taxable value** of property in each class, it is not uniform on the **full value.** Assuming the rate of levy in a given taxing district to be 30 mills on the taxable value, the rate on the full value of property in class 1 would be 15 mills; in class 2, 7½ mills; in class 3, 10 mills, and in class 4, 12 mills.

This year approximately 13 per cent of the full value of all property subject to a millage tax, except money and credits, is in class 1; 2 per cent in class 2; 56 per cent in class 3, and 29 per cent in class 4, the tax being extended in the respective classes at 50, 25, 33 1-3, and 40 per cent of full value.

Some misapprehension exists as to the scope and effect of the constitutional amendment of 1906. It is sometimes referred to as the "wide open" tax provision of the constitution. This is a mistake, for the power to classify under the amendment is a limited one. As already stated, it simply changed the rule of uniformity on all classes of property to uniform on the same class of subjects.

The power to classify, then, is not an arbitrary one. Perhaps it would be unwise to remove all constitutional restrictions on tax legislation, although not a few people believe that in this progressive and intelligent age such legislation may be safely entrusted to the wisdom and judgment of the people's representatives. How-

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ever that may be, our legislature is still restricted in tax legislation to the rule of uniformity on the same class of subjects.

Perhaps it may be said that the phrase "class of subjects" is not very definite, and while this may be true, it is generally regarded as referring to property of the same general characteristics. The courts have held that classification to be valid "must be reasonable and such as is based on essential differences." While the expression "essential differences" may be variously construed, it is reasonable to assume that it means some fairly well recognized difference or distinction in the character or use of the property so classified.

Some fear was expressed at the time the tax amendment to the state constitution was under consideration that, if adopted, it might lead to radical tax legislation on the part of the legislature. That such fears were groundless has been fairly well demonstrated by our ten years of experience under the amended tax provision. While a number of tax laws, based on the power to classify property, have been enacted since the adoption of the amendment, nothing of a radical or drastic nature has been written into the taxing laws of the state. Each new law has marked a step in advance along the lines of tax reform. While no claim is made that we have reached perfection—if there is such a thing as perfection in tax laws—yet we are making progress, and no thoughtful student of taxation in the state would today willingly go back to the old rigid and inflexible rule of tax uniformity on all classes of property.

The Exemption of Personal Property

As pointed out in an earlier part of this chapter, the complete exemption of personal property from taxation could not be brought about without first amending the state constitution. It is a well established principle of law in this state that no property can be exempted from taxation unless such exemption is expressly provided for in the constitution. The only option in matters of tax exemption vested in the legislature is the power to exempt personal property to an amount not exceeding $200 in value. Such exemption, however, may be less than $200, but cannot be more and may be extended to each household, individual, or head of a family, as the legislature may determine.

If all forms of personal property were exempted from taxation the tax base would be considerably reduced. In 1915 the total

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assessed value of real and personal property subject to an ad valorem tax was $1,730,216,117. Of this amount $1,284,150,906 represented real estate, $233,368,380 general personal property, and $212,696,831 money and credits.

For the purpose of determining the tax paying ratio of real to personal, let us assume that the three-mill tax on money and credits is equal to one-tenth of the average tax on other property. On this basis the taxable ratio of real to personal would be approximately 83½ per cent to 16½ per cent of the total. It therefore follows that if personal property were entirely eliminated from the tax rolls it would be necessary to increase the tax rate approximately 20 per cent on real estate in order to raise the same amount of revenue we now derive from a tax on both classes of property.

The exemption of personal property, however, would increase the real estate tax relatively more in the urban than it would in the rural districts of the state, because the reduction in the tax base would be greater in the former than in the latter.

In 1915 the ratio of real to personal, exclusive of mineral property and money and credits, was 76 per cent to 24 per cent in cities and villages, while in the rural districts it was approximately 89 per cent of real to 11 per cent of personal. This would mean an average increase of more than 31 per cent in the real estate tax in urban districts, and about 12 per cent in the rural districts of the state to raise the same amount of revenue we now get from both classes of property.

This does not necessarily mean that each urban land owner would pay 31 per cent and each rural land owner 12 per cent more in taxes than they are now paying. In many cases the increase in real estate taxes would be more than offset by the saving in personal property taxes. If the relative taxable value of the real and personal property of each taxpayer was the same, the indicated change in the tax base would not affect the amount of the tax to be paid; it would simply change the incidence of the tax. However, in the case of the owner of large real estate holdings and relatively small personalty, the change in the tax base would undoubtedly increase his taxes, while the opposite would be true in the case of the man whose investments were largely in personal property.

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These deductions, of course, have no bearing on the economic questions involved in the exemption of the products of labor from all forms of taxation. They simply point to the effect the change in the tax base would have on the incidence of the tax. Many earnest and thoughtful students of political economy are opposed to a tax on anything that comes from human ingenuity or human toil. They contend that a tax on the products of labor is a tax on thrift and industry, and therefore detrimental to public welfare. Whether the theory be right or wrong, we are satisfied that the people of this state are not yet ready to entirely abolish taxes on all forms of personal property.

Partial Exemption of Personal Property

While total exemption of personal property could not be put into effect under the present tax provision of the state constitution, partial exemption could be brought about through the power of the legislature to classify property for purposes of taxation. The taxing of one class of property at a lower percentage of full value than other classes is equivalent to the partial exemption of the favored class. The principle of partial exemption is recognized in our present law as to certain property, and could be further extended if deemed advisable.

Household goods could be made a favored class. Few states or countries impose any tax on this class of property. Its complete exemption is desirable from almost any viewpoint, whether economic or administrative. Complete exemption, of course, would require a constitutional amendment. Almost complete exemption, however, could be brought about under the present tax provision of the state constitution. The taxing of such property at a low percentage of value, say 10 per cent, would result in the exemption of the greater part of it. By increasing the amount that may be deducted from a personal property assessment to $200, almost complete exemption would be brought about. In event that the deduction was increased to the constitutional limit, it might be advisable to have it apply only to household goods, or all of the property now embraced in class 2 of personal property.

It would not be necessary to confine the low rate to household goods only. The principle could be extended to other classes of property desired to be favored. For instance, the tools, implements and machinery of the farmer and the manufacturer could be made

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a separate class and a low percentage applied to them. Minnesota is not only a great agricultural state, but is rapidly developing into a great manufacturing state. Such development should not be retarded by a burdensome tax on the instruments of production. If the principle of favored classes in taxation is to be still further extended, we believe it could well be applied to tools, implements and machinery used in both agricultural and industrial pursuits.

In any consideration of favored classes of personal property for purposes of taxation, the rule of reasonableness laid down by the courts should not be overlooked. Whether a nominal tax on household goods and on the implements of industry would be sustained by the courts is a question we are not prepared to answer. The three-mill tax on money and credits, which is less than one-tenth of the average tax on other property, has been upheld, and it is not improbable that a relatively low tax on the classes of property here under consideration would also be upheld.

The Exemption of Buildings and Improvements

The principle of total or partial exemption from taxation of buildings and other improvements on lands has many advocates in this state. Total exemption would require a constitutional amendment, while partial exemption through classification could be put into effect by legislative enactment.

The total exemption of buildings and improvements would affect the tax base to a much greater extent than would the exemption of personal property, because they constitute a much greater percentage of the total assessment. Then, too, the exemption of this class of property would affect the incidence of the tax to a much greater extent than would the exemption of personal property, because the relative value of land to buildings is much greater in the rural than in the urban districts of the state, while the relative difference in the value of personal property is not so pronounced.

Excluding mineral properties, the relative value of land to structures in 1916, based on the assessment of the present year, is 88 per cent of the former to 12 per cent of the latter in rural districts, while in the urban districts land values represent 46 per cent and structures 54 per cent of the total combined value. Based on

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these figures, the real estate tax base would be reduced 12 per cent in rural and 54 per cent in urban districts if structures on lands were exempted from taxation.

The reduction in the tax base caused by the exemption of structures would not materially affect the incidence of the tax so far as local rates are concerned. It would result, however, in a substantial change in the incidence of the county and state tax. Because of a greater reduction in the urban base than in the rural base, the former would pay less and the latter more of the county and state tax than they now pay, should structures be entirely exempted from taxation.

The shifting of the tax from land and improvements to land alone would in many cases considerably affect the amount of taxes to be paid by the individual land owner. If the increase in the land value did not exceed the value of the exempted improvements, there would be no increase in the taxes. If the value of the structures was greater than the value of the land, there would be a decrease in the individual tax. But, on the other hand, if the value of the land was materially greater than the value of the structures, the shifting of the tax would result in a corresponding increase in the amount of taxes to be paid.

The holder of unimproved land would, of course, be the most seriously affected by the change because there would be no corresponding offset for structures to compensate for the increased tax on the land. This is one of the reasons why the principle of total exemption of improvements on land is favored by so many people. They do not regard the speculator or the man who holds land out of use a public benefactor. They contend that he does nothing to create value but benefits through the energy and enterprise of others, and that therefore a considerable part of the value created by the community should be taken for the benefit of the community.

Partial Exemption of Structures and Improvements

As already stated, the entire exemption from taxation of buildings and improvements on lands could not be put into effect under the present tax provision of the state constitution. Partial exemption, however, is now in effect through the classified assessment law, structures on platted property being taxable at 40 per cent and

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on unplatted property at 33 1-3 per cent of value. But except as to classes, no distinction is made between land and buildings, both being taxable at the same ratio of full value. It therefore follows that the tax burden at the present time is the same on buildings and improvements on land as on the land itself.

The authority to classify property conferred upon the legislature by the tax amendment of 1906, undoubtedly empowers it to designate buildings and improvements on land as a separate class of property, and to provide for the assessment of such property on a different basis of value from that of the land upon which they are located. That there is an essential difference in the character of the two kinds of property will be generally admitted. One is the result of the expenditure of capital or labor, or both; the other, a gift of nature made valuable by the presence and needs of the community. It would therefore seem that if real estate is to be classified for purposes of taxation, a division along the lines of man-made values as distinct from community-made values is not only more logical, but economically more sound than our present somewhat ambiguous and indefinite "platted and unplatted" classification.

While the present classification of real estate, from an administrative point of view, is much more satisfactory than the old unenforcible uniform system, it can scarcely be justified on any grounds of sound economic reasoning. To say that when land is subdivided into small tracts, 20 per cent should be added to the assessment, as the present law does, is to say that the workingman's home in a city or village should be taxed relatively 20 per cent higher than a productive farm adjoining such city or village.

But while the principle of applying a different percentage of taxable value to platted and unplatted lands has little to commend it from the viewpoint of equitable taxation, it is doubtful if any sudden change in the system would be wise. The practice has been followed so long and is so interwoven with our state and local revenue systems that any sudden change would probably make matters worse instead of better. A sudden radical change in a tax base is of doubtful wisdom at any time, and is especially so if the change is liable to seriously disarrange public finance. Experience has demonstrated that when a material change in a tax base is desired, it is wise to effect it through a gradual change rather than by a single step.

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It may be said that a bad tax system should not be continued on the mere ground of public expediency. While this may be true, the wisdom of any material change in a tax system, unless backed by a strong and well defined public sentiment, is problematical. That a considerable sentiment exists in the state in favor of a uniform tax rate on land regardless of whether it is platted or unplatted, and a different and lower rate on structures, will not be denied. It will scarcely be claimed, however, that the state is yet ripe for any radical difference in the tax rate on land and buildings.

Conclusions

As a result of an extended study of the taxing system of other states and countries, we believe the resolution of the All-Minnesota Development Association, favoring a lessening of the tax burden on personal property and on buildings and improvements on land, referred to in the opening paragraph of this chapter, presents a number of questions worthy of the thoughtful and earnest consideration of the law-making body of the state.

While the recommendation of the development association involves both social and economic questions, it also involves another question of greater immediate importance, and that is, the effect the proposed shifting of the tax burden would have on state and local revenues. A slight change, or a moderately graduated change, would, of course, lessen the importance of the revenue question involved in the proposition, but all of them should be fully and impartially considered in connection with any proposed material change in the tax base.

The recommendation in favor of a reduction of the tax burden on personal property will meet with general approval. The economic questions involved in the principle of exemption of property of this character have been briefly discussed in an earlier part of this chapter and need not be repeated here. It has also been shown that complete exemption of personal property would mean a considerable increase in the tax burden on lands, unless public expenditures were considerably curtailed, of which there is little prospect at the present time.

As already stated, we do not believe that the state is yet prepared for the radical change in the tax base that would result from a complete exemption of personal property. Nor do we

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believe it would be wise to effect entire exemption of such property at one stroke, unless, and concurrent with the change, we adopted a substituted tax, such as a business tax, or a state income tax. In any event, it will be generally conceded that if a material change is to be effected in a tax base it should be brought about gradually, rather than at a single step, in order that each community may also gradually adjust its revenues and expenditures to the changing tax base.

But while a complete exemption of all forms of personal property may be neither feasible nor desirable at this time, we believe that the partial exemption of some types and the total exemption of other types of such property is feasible and desirable, from both an administrative and an economic viewpoint.

We believe that property now embraced in class 2, household goods and the furnishing and adornments of the home, is a type that should be exempted from taxation. While the best method of effecting such exemption would be by constitutional amendment, almost complete exemption could be brought about, as already suggested, by providing for a lower percentage of taxable value than we now have, with an increase in the personal property deduction to $200, limiting the deduction to this class of property only. Exemption by constitutional amendment is preferable to exemption by classification, because the latter method would not relieve assessing officials of the irksome and expensive work connected with the listing and assessing of property of this character.

The tools and implements of industry are types of property that might well be placed in a favored tax class. They constitute the instruments with which wealth is produced. Apart from any economic question involved in the proposition, good common sense would suggest that the tools of production should not be subject to a burdensome tax. We are therefore of opinion that it would be in the interest of the public good to place farm tools and live stock used in agricultural pursuits, and the tools and machinery of mechanics and manufacturers, in a separate class and tax them at a lower percentage of full value than that imposed on articles of trade and commerce.

Other types of property, such as seed grain and fodder for live stock on the farm, might also be placed in a favored class. It is almost impossible to enforce the present provision of law imposing a tax on seed grain and feed at one-third of full value. It is an

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irritating tax to a majority of the farmers. They regard it as wholly unjust and generally refuse to list such property in their tax returns. The revenue derived from it is negligible. At the same time it causes more false swearing in tax returns than perhaps any other class of property subject to taxation. It would be in the interest of public honesty either to place such property in a low class or wholly exempt it from taxation.

The recommendation of the development association favoring a reduction of tax burdens on buildings and improvements on lands presents problems that are much more difficult of equitable solution than its recommendation favoring a lessening of tax burdens on personal property. If the relative value of improvements to lands was equal, or nearly so, in each taxing district of the state, a reduction in the taxable value of the former would not disturb the relative equality of the tax base. But with buildings representing about 54 per cent of the taxable value of platted real estate and only 12 per cent of the taxable value of unplatted real estate, a percentage decrease in the taxable value of buildings would reduce the tax base much more in cities and villages than it would in the rural districts of the state. This would result in an increase in the proportion of state taxes to be paid by rural districts and a decrease in the proportion to be paid by urban districts.

From an economic point of view, the recommendation in favor of a reduced tax on buildings will be favorably regarded by a great many people. The practical side of the question, however, offers a serious stumbling-block to any immediate adoption of the proposal. If the various municipal organizations of the state were independent taxing districts, as in western Canada, and were not subject to a state or county tax, the adoption of the principle of total or partial exemption of buildings from taxation would be greatly simplified. As independent taxing districts, a change in the tax base would only affect the incidence of the tax locally. But as long as state, county, and local taxes are levied on the same tax base, it is not at all probable that the rural districts would willingly agree to a change that would result in a considerable increase in their proportion of state and county taxes.

It is probable, however, that the unequal effect the partial exemption of buildings would have on the tax base of rural and urban districts could be largely overcome if the words "struc-

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tures and improvements on lands" were construed as including the added value that accrues from the clearing and cultivation of land. If "land value" was construed to mean the value of the land exclusive of any increase due to the expenditure of capital or labor, and "improvements" construed to include such increase, the relative value of land to improvements in rural districts would probably not greatly differ from the relative value of the two classes of property in urban districts. In such case, the assessment of improvements on a lower basis of value than land would not seriously change the equality of the tax base in urban and rural districts.

We are not prepared to express an opinion at this time as to the feasibility of the plan of construing all increase in the value of land resulting from the expenditure of capital or labor as "improvements on land." The plan is in effect in two of the western Canadian provinces and seems to be giving reasonable satisfaction. If it could be successfully applied in this state, it would remove some of the objections now urged against the proposal that improvements on land should be taxed at a different and lower percentage of value than the land itself.

Another alternative would be the separation of the sources of state and local revenues and a wider application of the principle of local option in taxation. It would not be difficult to so readjust state revenues as to render unnecessary any general tax levy for purely state purposes. If this were done, the proposed lessening of the tax burden on buildings would not seriously disturb the relative equality of taxes because it would only affect local rates. However, the separation of the sources of state and local revenues and a more extended use of the principle of local option in taxation open up other questions not altogether pertinent to the subject of this chapter, and upon which we express no opinion at this time.

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