

## Chapter 21

### The Land and Taxes

#### The European Precedents

As since early times land was the principal form of wealth and income, it has been an object of taxation either directly or indirectly. According to the late Professor E. R. A. Seligman,<sup>1</sup> the ownership of agricultural land and real estate, along with other forms of property—i.e., the ownership of wealth in general—was regarded as a basis for the faculty of the individual to pay taxes. During the two centuries preceding the nineteenth century there gradually developed a system of classifying the items of wealth on the basis of their income production. This was not exactly a general income tax, such as we know it today, but was a step in that direction. It constituted merely the adoption of product or produce as things and not as a norm of taxation. It was still a tax on things and not on persons, and, in the process of assessing and levying the tax, no account was taken of the relative ability of the taxpayer to pay the tax. This system still prevails in most of the states of the Union, where real estate is assessed and taxed on a classification basis rather than on the actual income produced by each item assessed.

As the early American colonists came from England and were familiar with the tax systems of that country, the tax practices and theories that prevailed in Britain in the seventeenth and eighteenth centuries were naturally applied, as far as circumstances permitted, in the new settlements. In Britain, as in most other European countries, as stated in the previous paragraph, the early practice had been to levy

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<sup>1</sup>*The Income Tax*, 2nd ed., pp. 12-15.

land taxes (including tithes) on the gross produce of soil. Later and gradually, the basis for the assessment was an assumed net product, thus making allowance for the expenses of cultivation.

Inasmuch as in those days it was highly impractical to calculate the net product of each individual parcel of cultivated land, the land had to be classified and the net product, actual or potential, fixed on the basis of the classification. As stated by Professor Seligman, although the method was undeniably a step in advance, it was not sufficient to create justice and equality in taxation. "The net produce of two farmers," as pointed out by Seligman, "after allowing for the expenses of cultivation, may be precisely the same but if the owner of one farm has purchased it on a mortgage, his final net earnings will be less than that of his neighbor. The net produce of a piece of property, in other words, is no necessary indication of the net revenue to the owner. The tax upon the thing, just because it is upon the thing, does not lend itself readily to the shifting conditions of the man who owns the thing; and yet the real ability of a person to pay taxes must be in some relation to his individual condition."<sup>2</sup>

While there is some difference of opinion regarding the foregoing argument, the tendency has been, as shall be shown later, to tax both improved and unimproved property on the basis of the tax being permanently fixed to the property. In other words, the tax is highly impersonal, the financial position of the taxpayer and his ability to pay not generally being taken into account. Thus the principle of a progressive tax has not been applied to land through progressive income taxation. Under a progressive rate of taxation, the net product or income from the land and its improvement, over and above the expenses of maintenance or cultivation, would be levied on the property but would be adjusted in order to be met by the individual taxpayer according to his financial situation.

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### Early Colonial Land Taxation

As Professor Richard T. Ely has stated in his pioneer work, *Taxation in American States and Cities*: "In the earlier days of the colonies there

<sup>2</sup>*Ibid.*, pp. 14-15.

was no great need for taxes. The mother country asked no assistance from them; quitrents satisfied the demands of the proprietor or the company, who in turn promised at least partial protection; fierce wars had not yet transferred the burden of defense to the shoulders of the people; the public wants of the colonists themselves were simple and easily supplied; there were few officials; and these were either wholly without compensation, or received but a few slight fees; and the chief and almost sole objects of their contributions were churches, schools and highways."<sup>3</sup>

Because of the scarcity of currency and the plentifulness of unoccupied land, it was the common practice in early colonial days to compensate officials and others for public services by grants of land. This had also been a practice in England but was limited to an endowment for extraordinary services to the state and was a relic of feudalism. In the colonies, however, it was applied to ordinary services. Thus Robert Lenthall, schoolteacher and minister, received 104 acres of land from Newport, Rhode Island, in 1640 and 100 acres were appropriated for a school "for the encouragement of the poorer sort."<sup>4</sup> Many other instances of this sort could be cited. In fact, as already indicated, the practice persisted even after the adoption of the constitution, when the federal government granted land to road builders and others performing services or encouraging land settlement.

As the early settlers had to undergo the expenses and the delays of clearing as well as cultivating the lands, as a rule, they were consequently in no position to pay taxes on the land. The colonies, therefore, for the most part resorted to other means of obtaining necessary revenues. Even in the case of quitrents, provision was generally made that no payments would be demanded until after a lapse of years. Among the revenue sources applied by the colonies were occupational or so-called faculty taxes, licenses, excises, fees, fines, and occasional lotteries.

However, it must not be assumed that land in the colonial period escaped taxation. At various times and in later years as an annual assessment, direct taxes were laid either in proportion to property held,

<sup>3</sup>P. 107.

<sup>4</sup>*Ibid.*

real or personal, or as a uniform charge in the nature of a poll or head tax. Individuals and companies were frequently taxed on the mass of their property—i.e., its estimated total value—but, as land was by far the chief item of wealth in the colonial period, it bore the lion's share of this direct taxation and in some of the colonies became the object of a special tax. Thus in Virginia a poll tax was the only direct tax levied for a considerable period. Because of its inequity and consequent burden on the poorer classes, it was replaced in 1663 by a land tax.<sup>5</sup> In course of time, when because of the burden of the inequitable poll taxes they were largely abandoned, the general property tax came into vogue and has continued (particularly as a source of revenue for local authorities) until the present day.

### Land Taxation in the Early Federal Period

The American Revolution and the consequent formation of a federal government effected very little change, if any, in the systems or methods of taxation of the American states and local governments. There was no occasion for the states to alter substantially their tax laws, and the federal government refrained as far as possible from resorting to direct taxation, largely because of the constitutional provision which limited the method of such taxation to apportionment among the several states according to population.

The first important contemporary study of taxation in the early federal period was made in 1796 under the direction of Oliver Wolcott, then Secretary of the Treasury, who had been directed by Congress to prepare a plan for laying and collecting federal taxes, with reference to the levying of a direct tax. Wolcott pointed out the diversity among the states both as to the objects and principles of taxation and the methods of assessing, apportioning, and collecting the taxes. In seven states he found a uniform capitation or poll tax, whereas in other states no such tax existed. "Land was taxed in one state according to quantity, in another according to quality, and in a third not at all." As pointed out by Professor Ely, the diversity of the principles and methods of obtaining state revenues at the time was undoubtedly due to the relatively

<sup>5</sup>*Ibid.*, p. 111.

light burden of taxation in those days. There were both laxity and neglect in the collection of the state taxes, while the localities, counties, and towns found sufficient revenues from indirect rather than direct sources to carry out their public services.

As an indication of the early laxity in land taxation, the new state of Tennessee in 1796 had a provision in its constitution which stated that "all lands are liable to be taxed, and they shall be taxed uniformly, so that no 100 acres shall be taxed higher than another, except town-lots. No freeman shall be taxed higher than 100 acres of land, and no slave higher than 200 acres. No article of manufacture shall be taxed except to pay expenses of inspection." A similar system of taxing land prevailed in Vermont at this early period.<sup>6</sup> Here we have a case of inequitable land taxation which very likely came into being because of the large landholdings of individuals who undoubtedly controlled or influenced legislation of the period.

Professor Ely in his book, *Taxation in American States and Cities*, already quoted, presents a table indicating the various sources of state revenues in 1796. This table reveals that all except one of the fifteen states then in the Union had a land tax, though four also had a general property tax. Thus there is evidence that land and real estate taxation had already become a source of state and local revenue after the Revolution. The dependence on land as a source of direct taxation is to be expected in a period when land constituted the principal item of private wealth in the community.

In giving details of taxes on land in 1796, Professor Ely discloses a variety of methods of taxation. "In Vermont all lands which had been improved two years and were within enclosure, and in North Carolina all lands, excepting town lots, which were assessed according to valuation, were taxed uniformly according to quantity. In Rhode Island and New York lands, together with all other property, real and personal, were taxed according to estimated valuation. They were assessed in Massachusetts and New Hampshire according to their products or supposed annual rents. A peculiarity of this tax in the latter state was the arbitrary and variable size of the acre. It was not a certain number of

<sup>6</sup>See Frederick A. Wood, *The Finances of Vermont*, p. 19.

square rods, but was a sufficient quantity of orchard land to produce ten barrels of cider, or of arable land to produce twenty-five bushels of Indian corn, or of mowing land to produce a ton of hay. A quantity of land sufficient to support a cow one year was regarded as four acres. In Connecticut no regard was had for the value of lands in their assessment, but all were assessed uniformly according to the mode of cultivation or condition, each kind being placed in the list at a fixed rate; as for example, meadow lands at \$2.50 per acre. Taxes were levied on land in Pennsylvania according to a triennial valuation, in Virginia according to a permanent valuation.

"The average or relative value of lands in different counties or districts was fixed by law in Maryland and New Jersey, and this average value multiplied by the number of acres therein became the basis of taxation. Within the counties or districts, lands contributed to the total sums assessed to them in proportion to their value. Lands in Kentucky, except town-lots, were divided into three classes according to quality, and, in South Carolina and Georgia, lands were taxed uniformly by districts or classes, whether cultivated or not. Delaware had no direct tax on land, but a tax was levied on the income from land in a general income tax."<sup>7</sup>

#### Land Taxation Merges into the General Property Tax

From the beginning of the nineteenth century through the period of the Civil War and thereafter, the nation witnessed an industrialization that diversified and intensified the various forms of property and wealth. This acted to decrease the dependence on land as a source of public revenue, and it did actually decrease the relative burden on land as its value increased more rapidly than the general tax load. Nevertheless, as the aggregate weight of taxes increased, state and local governments, and particularly the latter, came to rely more and more on the taxation of land and improvements. Under this so-called "general property tax," which supposedly levied on real and personal property alike, real property, owing to its tangible nature which defied concealment, tended to bear a relatively greater burden, and personal property,

<sup>7</sup>*Op. cit.*, pp. 119-20.

whether productive or non-productive, fell comparatively in importance as a revenue source. In practically all states and municipalities, the proportion of revenue accruing from personal property under the general property tax has been declining for years, with the result that in many states and local taxing bodies the assessment of personal property has been abandoned and the old special land and house taxes have been restored. Thus land, and the improvements thereon, is still the fertile source of revenue to the states and their subdivisions.

But the general property tax today, comprised largely as a tax on realty, is not an equitable or logical tax. In most cases it taxes both the land and the improvements thereon at the same rate. Although it taxes both productive and unproductive property, it penalizes productive improvements by placing on them a tax burden. Moreover, it permits the holding of real estate from productive use with the prime motive of gaining the rise in future rental value; i.e., the unearned increment.

For this reason alone, agricultural lands and land sites not put to productive use, or held merely for speculative purposes, should bear a higher tax rate than the tax levied on real estate improvements. Even the late Professor Seligman, who strongly decried the taxing of unproductive property, supported this principle. In his *Essays in Taxation*, he writes:

The great element of reason in the demand for the taxation of unproductive property is to be found in the assessment of real estate. It is an undoubted fact that real estate is often held for speculative purposes and that it is the duty of the community not to encourage such speculation by exempting vacant lands from taxation. The owner expects to reap from the future value of the land, whether he sells or keeps it, a sum more than sufficient to recompense him for his outlay and intervening loss of interest and profit. He is prospectively earning an annual revenue from the land, whose present unproductiveness is technical rather than real. It is thus perfectly logical to tax unproductive real estate, even though the basis of taxation be product rather than property. It is the estimated, rather than the actual, product that is taxed.<sup>8</sup>

<sup>8</sup>1st ed., p. 58.

The most notable case of holding real estate in an unimproved condition for purposes of profit is, as stated previously, that of John Jacob Astor. As there noted, Astor as early as 1800 pursued a policy of utilizing his mercantile gains in the purchase of land just beyond the city limits. He gradually sold this land at an advanced price and used the proceeds to buy more extensive tracts somewhat farther out. Much of this land was held unimproved by the Astor Estate for upward of a century. In the meantime, as New York City rapidly expanded because of increase of population, the land advanced in value manifold, undoubtedly far in excess of the taxes paid and the compound interest on the original investment.

The benefits derived by individuals and corporations in holding land in an unimproved condition for profit at the expense of the public and as hindrance of economic progress have been recognized by economists and social philosophers for several centuries, and, as shall be pointed out in the following chapter, ways and means of offsetting the evil have been proposed. It has been widely discussed in American as well as European economic literature, but as yet little action of a positive nature has been taken to meet the problem. Possibly constitutional limitations, wherein the tax laws require conformity to certain methods of assessment for tax purposes, have been the greatest impediment in correcting the evil through political action.<sup>9</sup>

#### Taxation of Improvements

The means most commonly attempted in several American states to discourage landholdings for speculative purposes was to tax bare land value at a higher rate than the buildings and improvements made on the land. The distinguishment of buildings from the land itself in tax assessments has been followed in a few states from quite an early period. Thus at the beginning of the last century Kentucky taxed land without regard to improvements. Ohio, another new state, in 1825 enacted a law which provided that land should be valued "without taking into consideration the value of the actual improvements made

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<sup>9</sup>For a discussion of this topic, see H. G. Brown, *The Economic Basis of Tax Reform*.



thereon."<sup>10</sup> A few other states made attempts to follow out this principle. Thus it was early recognized in the development of American taxation systems that citizens should not be made to pay a penalty for adding wealth to the country. Yet, in spite of this, the general tendency for many years following the Civil War was to apply the "general property" principle, wherein all property, real and personal, improved and unimproved, productive and unproductive, was taxed at a uniform rate.

### The Incidence of Land Taxation

Although it is not the intention in these pages to enter into economic theories of taxation, the fact that the taxation of land and its improvements has become almost the exclusive tax on tangible wealth in America requires some discussion of the shifting and final incidence of such taxation. The question here is whether the tax on land or urban real estate (i.e., land and its improvements) is borne by the owner or the tenant or is divided between them. This question cannot be definitely answered, since various circumstances alter the results. As stated by the late Professor Seligman, who had devoted years to the study of the subject:

If our general property tax were actually enforced, then beyond all doubt the real estate tax would be entirely borne by the owner. But it is precisely in the American cities that the general property tax has become practically a real property tax. In other words, city real estate bears, if not the exclusive, at least the greater, weight of municipal taxation. In proportion as the city houses are taxed at a far higher rate than other capital, the main condition under which the tax may be shifted to the occupier is present. If we take the small American towns where the investments are mainly local, and where personal property is reached to a fairly good degree, then it is very probable that the real estate tax is not shifted to the occupier. But the larger the city and the greater the chances of investment in outside capital, the less will be the proportion of personalty taxed and the greater will be the possibility of a shifting of a part of the real estate tax.

<sup>10</sup>See Ely, *op. cit.*, p. 135.

And Professor Seligman concludes:

It may be said in short that while the real estate tax falls on the owner in case of stationary or declining population, a considerable portion of the tax is shifted on the tenant in the normal case of a prosperous town or city district under the present administration of our property tax. When we reflect that in the city of New York over three fourths [probably greater now] live in tenement houses, we are thus forced to the conclusion that a large burden of our American local taxation is today borne by those least able to pay. The question as to how far these may again be able to shift the tax on others is a part of the large question of the tax on property, profits or wages.<sup>11</sup>

### Proposals for Taxation as Remedies for the Land Question

Since equitable landholding and land taxation are bound up together, the solving of the problem of the land question may be approached through reforms in taxation. Two proposals have been presented. One is to tax land under a progressive-rate system, such as has been applied to the income tax. The other is the absorption of the economic rent of land through taxation, as proposed by Henry George. Both proposals may be applied simultaneously, as neither interferes or offsets the other, and no valid inequities would be involved. The application of a progressive rate of taxation to individual landholdings would naturally act as a damper on the monopolization and accumulation of land—an evil which has existed in civilized nations for centuries and which has been the cause of widespread discontent in many countries from Roman times to the present day. That it has not yet been seriously felt in the United States is due largely to the general abundance of land, its relative cheapness, and its rapid and widespread distribution. But it is undoubtedly manifest that with the continuous population growth and the encroachment of metropolitan and urban areas on tillable land, as well as the appropriation of large areas for industrial, mining, forestry, and even agricultural uses, land- and home-ownership are becoming more and more restricted to a relatively small segment of the nation's total population.

<sup>11</sup>*Op. cit.*, pp. 233-34

As yet no serious effort has been made to tax land on a rising progressive rate in accordance with the size and value of individual holdings. Many economists tell us such progressive taxation is impractical. The matter has been discussed, however, in several areas, and such a proposal has been made in California. The effect of such a tax may be problematical and its practicability may not undergo the test, but it should be remembered that "impracticability" was applied by critics and statesmen when Great Britain inaugurated the income tax in 1799.

The progressive rate of income taxes, which is almost universal throughout the civilized world, has been an important factor in promoting a redistribution of wealth and, if properly applied in relation to size and value of individual landholdings, could aid further in promoting this social reform. Moreover, the advantage of such a tax lies in its relative non-shiftability and inherent justice. There is no avenue by means of which the progressive rate could be transferred to others, whether tenants or consumers. Where large landownership arises from the nature or form of business operations, such as mining, forestry, or even agricultural enterprise, of course the progressive tax rate would not apply.

It is interesting to note that, probably because of the influence of Thomas Jefferson, the first federal direct tax law, enacted by Congress on July 14, 1798, provided for a progressive tax rate on land and improvements, the rate increasing with the value of the property assessed. According to the terms of the act, a tax was to be levied "upon every dwelling house, which, with the out houses appurtenant thereto, and the land whereon the same were erected, not exceeding two acres, shall not be valued at more than one hundred, and not more than five hundred dollars, the tax rate to be one tenth of one per cent." This rate was increased progressively, ranging from three tenths of one per cent on houses valued at more than \$500, up to one per cent on houses valued above \$30,000. This progression applied only to dwelling houses; agricultural lands could be assessed by the individual states at rates sufficient to make up their portion of \$2,000,000—the estimated receipts from the direct tax levy.<sup>12</sup>

<sup>12</sup>See Timothy Pitkin, *A Statistical View of the Commerce of the United States of America*, pp. 309-10.

### Land-Value Taxation

In taxation under equitable principles, it should be made clear that there is a difference between land and "real estate"; i.e., the bare land as such and the improvements made thereon. The former obtains its value because of its situs or fertility, which is a combination of natural advantages or the result of human progress. Its value, therefore, can be attributed to no single individual or group, but to peculiar circumstances in which all the populace plays a part. However, if capital and labor are applied to the land, such as erecting buildings and adding other improvements thereto, those that furnish the capital and labor create additional wealth. If such additions to wealth are taxed—and they are the sources of employment and sustenance to the commonwealth—then those who create wealth and give employment are penalized, while those who hold property which is the bounty of nature, intended for common use, suffer no penalties as long as the rise in value of such property more than compensates for the taxes levied thereon. Thus it is made manifest, and the theory is becoming widespread, both in this country and abroad, that, in taxation, the value of the land as distinguished from the value of the improvements thereon should be taxed exclusively or at a higher rate.

The arguments of those who support this theory have been well summarized by Dr. Harry Gunnison Brown:

The point of view of those who favor public appropriation of the annual rental value of sites and natural resources is that taxes should be so levied as to further the common welfare. . . . They stress the fact that the *annual rent* of land is a geologically- and socially-produced value; that the individual is not responsible for it and that it is socially undesirable for the private individual to enjoy it. . . . They call attention to the fact that not to take the economic rent of land as a first source of public revenue compels drawing more heavily on the earnings of labor and of thrift. And they conclude that a society in which the annual rent of land . . . is taken in taxation for public needs would be a far better society for the ordinary person to live in than the economic society we now have.<sup>12a</sup>

<sup>12a</sup>"Anticipation of an Increment and the 'Unearned Decrement' in Land Values," *The American Journal of Economics and Sociology*, Vol. 2, pp. 343-58.

The principle of the public appropriation of the annual value (or economic rent) of land has had widespread support ever since it was proposed so forcefully by Henry George in 1879. Indeed, it was put forward in some form or other by George's predecessors in land reform (notably Thomas Spence and John Stuart Mill). Here again there is a problem of "practicability." Can the return from the natural and inherent powers of the land be distinguished from the return received from its improvements? In most of our states the distinction already is being made in the periodic valuations of properties for tax purposes. But, assuming the difficulty to exist—as in some instances it must—this does not mean it is impossible to fix a criterion.

It should be noted as an argument against the impracticability of taxing the value of land in lieu of improvements, that such taxation has been in operation in widely separated areas for almost a half century. It has been applied in modified and different forms in Denmark, Australia, New Zealand and South Africa, and, in the United States, in Pittsburgh, Pennsylvania; Fairhope, Alabama; and Arden and Ardentown, Delaware. In quite another way, during the same period, "land-value increment taxes" were put into operation in Germany. These were taxes levied at the time a property was sold on the increment in the capitalized value of land.

Regarding the experience with land-value taxation in Australasia, Yetta Scheftel, writing in 1916 in her prize-winning book, *The Taxation of Land Value*, states:

In no case has there been a repeal of the tax except to extend its operation; in other words, after its adoption, however great the opposition may have previously been, the levy of the tax ceased to be a party measure. Indeed, the opponents of the tax seem to have become reconciled to its existence. Secondly, the adoption of the tax by one state after another, by the local bodies, and recently by the federal government of Australia, argues in its favor and for its expedience in that country.<sup>13</sup>

Concerning the application of the principle of increment-value taxation in Germany, which was used by various local governing bodies

<sup>13</sup>P. 120.

comprising the principal cities from 1904 until the end of World War I, and was adopted to some extent by the national government under the name of *Wertzuwachssteuer* (value increase tax), Dr. Frederic C. Howe, in his book *European Cities at Work*, published in 1913, states:

Community after community adopted it until in April, 1910, the tax had been introduced into towns and cities with an aggregate population of 15,000,000. Nor is there any substantial protest against it, in spite of the fact that real estate interests are active in city politics as well as the provision of the Prussian law that one half of the members of the city council must be owners of real estate. The tax meets with all but universal approval.<sup>14</sup>

### Summary

In summing up the question of land-value taxation, I can hardly do better than cite a paragraph from the philosophical work of Professor George Raymond Geiger, entitled *The Theory of the Land Question*.

Land value is not an industry-produced value. Its creation is an automatic and gratuitous social act, and its disposition in terms of taxation can have no negative effect on the processes that produce wealth. In fact, a tax on land values acts as a definite stimulant for production. The tragic paradox is that our present species of revenue-getting is largely one of self-mutilation. Society cripples itself by the continued sapping of wealth. It seems to do this deliberately, for always have there been theorists to point to the social fund of land value as a source of relief from this self-crippling.<sup>15</sup>

<sup>14</sup>P. 195.

<sup>15</sup>*Op. cit.*, p. 192. For treatises and discussions relating to the taxation of land-rent values, see Harry Gunnison Brown, *The Economics of Taxation; The Economic Basis of Tax Reform*; Yetta Scheftel, *The Taxation of Land Value*; Thomas G. Shearman, *Natural Taxation*. For contrasting views, see Seligman, *Essays in Taxation*, Chap. III; John Rae, *Contemporary Socialism*, Chap. XII; and W. H. Mallock, *Property and Progress*.